1934

Jun. 6—Motion for leave to amend petition, amendment tendered, filed by taxpayer. 6/8/34 granted. 6/13/34 copy served.

Jul. 23—Hearing had before Mr. Logan Morris, Div. 14. Submitted on merits. Stipulation of facts filed. Analysis of contracts filed. Petitioner's brief due August 31, 1934—respondent's Oct. 15, 1934—petitioner's reply brief Oct. 31, 1934.

Aug. 10—Transcript of haring of July 23, 1934 filed.

" 28—Brief filed by taxpayer. 8/29/34 copy served.

Oct. 11—Brief filed by General Counsel.

" 26—Motion for leave to file answer to amended petition, amendment tendered filed by General Counsel.

" 29—Reply brief filed by taxpayer. 10/29/34 copy served.

" 29—Motion for leave to amend granted.

1936

Jan. 16—Findings of fact and opinion rendered, Logan Morris, Div. 14. Judgment will be entered under Rule 50.

Feb. 14—Notice of settlement filed by General Counsel.

" 17—Hearing set March 4, 1936 on settlement.

Mar. 4—Hearing had before J. E. Murdock, Div. 3 on settlement under Rule 50. Not contested. Referred to Mr. Morris for decision.

1936

Mar. 24—Decision entered, Logan Morris, Div. 14.
" 24—Consent to settlement filed by taxpayer.
" 26—Order that insofar as it pertains to docket 72502, decision entered March 24, 1936 is hereby vacated, entered.
Jun. 23—Supersedeas bond in the amount of $3000.00 approved and ordered filed.
" 23—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by taxpayer.
" 23—Proof of service filed by taxpayer.
" 23—Statement of evidence lodged.
" 23—Notice of lodgment of statement and of hearing on July 8, 1936 to approve statement filed.
" 23—Praecipe with proof of service thereon filed. [1*]
Jul. 3—Notice of appearance of Hugh C. Bickford as counsel filed.
" 3—Motion for continuance to July 22, 1936 filed by taxpayer. 7/7/36 granted.
" 21—Agreed statement of evidence lodged.
" 21—Agreed statement of evidence approved and ordered filed. [2]

*Page numbering appearing at the foot of page of original certified Transcript of Record.

APPEARANCES.

For Taxpayer:
A. L. WEIL, Esq.,
HUGH C. BICKFORD, Esq.

For Comm'r:
GEORGE D. BRABSON, Esq.,
J. W. SMITH, Esq.

Docket No. 72502.

BANKLINE OIL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES.

1933

Jun. 5—Petition received and filed. Taxpayer notified. (Fee paid)

" 5—Copy of petition served on General Counsel.

Aug. 3—Answer filed by General Counsel.

" 12—Copy of answer served on taxpayer.

1934

Apr. 18—Hearing set for week of July 2, 1934 at San Francisco, Calif.

Jun. 6—Motion for leave to amend petition, amendment tendered, filed by taxpayer. 6/8/34 granted.

1934

Jul. 23—Hearing had before Mr. Morris, Div. 14 on merits. Stipulation of facts filed and analysis of contracts filed. Petitioner's brief due 8/31/34—Commissioner's brief due Oct. 15, 1934—petitioner's reply brief due Oct. 31, 1934.

Aug. 10—Transcript of hearing of July 23, 1934 filed.

" 28—Brief filed by taxpayer. 8/29/34 copy served.

Oct. 11—Brief filed by General Counsel.

" 18—Copy of amended petition served on General Counsel.

" 26—Motion for leave to file answer to amended petition filed by General Counsel. Oct. 29, 1934 granted.

" 29—Reply brief filed by taxpayer.

1936

Jan. 16—Findings of fact and opinion rendered, Mr. Morris, Div. 14. Judgment will be entered under Rule 50.

Feb. 14—Notice of settlement filed by General Counsel.

" 17—Hearing set March 4, 1936 on settlement.

Mar. 4—Hearing had before Mr. Murdock, Div. 3 on settlement under Rule 50—not contested—referred to Mr. Morris for decision.

" 24—Decision entered, Mr. Morris, Div. 14.

" 24—Consent to settlement filed by taxpayer.

1936

Mar. 26—Order that insofar as it pertains to Docket 72502, decision entered March 24, 1935 is hereby vacated entered.

" 28—Decision entered, Mr. Morris, Div. 14.

Jun. 23—Supersedeas bond in the amount of $3000.00 approved and ordered filed.

" 23—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by taxpayer.

" 23—Proof of service filed by taxpayer.

" 23—Statement of evidence lodged.

" 23—Notice of lodgment of statement and for hearing on July 8, 1936 to approve statement filed.

" 23—Praecipe with proof of service thereon filed. [3]

Jul. 3—Notice of appearance of Hugh C. Bickford as counsel filed.

" 3—Motion for continuance to July 22, 1936 filed by taxpayer. 7/7/36 granted.

" 21—Agreed statement of evidence lodged.

" 21—Agreed statement of evidence approved and ordered filed. [4]

United States Board of Tax Appeals.

Docket No. 56484.

BANKLINE OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEAL.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:E-3 dated February 20, 1931, and as a basis of its proceeding alleges as follows:

I.

That petitioner is a corporation organized under the laws of the State of California, with its principal office at No. 256 Montgomery Street, San Francisco, California.

II.

The notice of deficiency, a copy of which is attached and marked "Exhibit A", was mailed to petitioner as petitioner [5] is informed and believes on February 20, 1931.

III.

That the taxes in controversy are income taxes for the calendar years 1927 and 1928, there being an alleged deficiency of $8,903.92 for the year 1927, and $2,551.85 for the year 1928.

IV.

The determination of the tax set forth in said letter is based on the following errors, to-wit:

1. For the year 1927 the Commissioner has added to income the amount of $1,521.11 with the statement that "(a) Profit on sale of miscellaneous equipment credited against depreciation is restored to income." The petitioner claims the Commissioner has erred in increasing income by this amount, as the books of the company and the income tax return properly reflect the transactions involved in the sale of capital assets.

2. For the year 1927 the petitioner included as a deduction from income the amount of $373,185.97 under the caption of bad debts. The Commissioner has recomputed the loss to be $273,540.34, and has added to income the difference amounting to $99,645.63. The petitioner claims that the Commissioner has erred in disallowing the amount deducted as claimed in the income tax return.

3. The petitioner, in its 1927 income tax return, claimed depreciation on its casinghead gasoline plant at the rate of 16 2/3% per annum. The Commissioner has allowed 10%. The petitioner claims the Commissioner has erred in disallowing the 16 2/3%. [6] The question of the proper allowance for depreciation of the petitioner's casinghead gasoline plant is now before the Board of Tax Appeals, involving prior years. The petitioner claims that the depreciation on its oil well equipment in the Signal

Hill Oil Field should be computed on the unit basis, instead of at the rate of 10% per annum as allowed by the Commissioner. This matter is also now before the Board of Tax Appeals for prior years.

4. The petitioner, in the income tax return for 1927, claimed the deduction of $862.50 for commission paid in the year on lots sold in the year 1926. This deduction is disallowed by the Commissioner. As the amount was paid in the year 1927 the petitioner claims the Commissioner erred in disallowing the deduction.

5. The Commissioner has included as income in 1928 the amount of $1,605.54 for sale of assets. The petitioner claims this adjustment in the profit from sale of assets is in error and should not be added to income, as the amount of accrued depreciation as computed in the agent's schedule is in error, and not in agreement with the corrected accruals for depreciation.

6. The petitioner, in its income tax return for 1928, included as a deduction the amount of $2,441.00 paid the Government in the year in settlement of its capital stock tax of 1926. The petitioner claims this is an allowable deduction in the year 1928 and that the Commissioner erred in disallowing same and claiming it only a deduction for the year 1926. [7]

7. The petitioner, in its 1928 income tax return, claimed depreciation on its casinghead gasoline plant at the rate of 16 2/3% per annum. The Com-

missioner has allowed 10%. The petitioner claims the Commissioner has erred in disallowing the 16 2/3%. The question of the proper allowance for depreciation of the petitioner's casinghead gasoline plant is now before the Board of Tax Appeals involving prior years. The petitioner claims that the depreciation on its well equipment in the Signal Hill Oil Field should be computed on the unit basis, instead of at the rate of 10% per annum as allowed by the Commissioner. This matter is also now before the Board of Tax Appeals for prior years.

WHEREFORE petitioner prays that this Board may hear the proceeding and cancel the over-assessment.

A. L. WEIL
Counsel for Petitioner
310 Sansome Street
San Francisco, California

State of California
City and County of San Francisco—ss.

W. E. KROPP, being first duly sworn, deposes and says:

That he is the secretary of the petitioner; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; that the facts stated are true except as to those matters stated to be on information and belief, and as to those matters he believes it to be true.

W. E. KROPP

Subscribed and sworn to before me this 9th day of April, 1931.

LILLIAN RALSTON

Notary Public in and for the City and County of San Francisco, State of California. [8]

"EXHIBIT A"

TREASURY DEPARTMENT

Washington

Office of

Commissioner of Internal Revenue NP-2-26-28

Feb. 20, 1931.

Bankline Oil Company,
310 Sansome Street,
San Francisco, California.

Sirs:

You are advised that the determination of your tax liability for the years 1927 and 1928 discloses a deficiency of $11,455.77 as shown in the statement attached.

In accordance with section 274 of the Revenue Act of 1926 and section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of

your tax liability for the years in which a deficiency is disclosed.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET
Commissioner.
By (S) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
Schedules 1 to 4, inclusive. [9]

STATEMENT.

IT:AR:E3
FCC-60D

In re: Bankline Oil Company,
310 Sansome Street,
San Francisco, California

TAX LIABILITY

Years	Tax Liability	Tax Assessed	Deficiency
1927	$ 8,903.92	None	$ 8,903.92
1928	52,122.90	$49,571.05	2,551.85
Totals	$61,026.82	$49,571.05	$11,455.77

The determination of tax liability shown herein is based upon reports of the revenue agent in charge at San Francisco, California, copies of which have been furnished you, and upon other data on file in this office.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the years 1927 and 1928, the Bureau will be unable to afford you an opportunity under the provisions of article 1211 of Regulations 69 and/or article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 274(a) of the Revenue Act of 1926 and/or section 272(a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency.

In the determination of tax liability shown herein, the statements made in your claim for the refund of $751.42 have been carefully considered. [10]

Bankline Oil Company Year ended December 31, 1927

SCHEDULUE 1

Net Income

Net loss as disclosed by return		$105,252.66
As corrected (net income)		65,954.94
Net adjustment		$171,207.60
Unallowable deductions and additional income:		
(a) Sale of equipment	$ 1,521.11	
(b) Adjustment of loss	99,645.63	
(c) Depreciation	75,378.55	
(d) Commission on lots sold	862.50	
Total		177,407.79
Nontaxable income and additional deductions:		
(e) Additional loss	$ 1,514.29	
f) Additional depletion	4,685.90	
Total		6,200.19
Net adjustment as above		$171,207.60

SCHEDULE 1-A

Explanation of Items Changed.

(a) Profit on sale of miscellaneous equipment, credited against depreciation is restored to income.

(b) The loss claimed on the notes of The Spring Company has been disallowed. It is held that this amount does not constitute a bad debt.

(c) Depreciation on absorption plant is allowed at the rate of 10% which this office holds to be an adequate return of the amount of wear and tear on this asset.

(d) Commission paid on lots sold in 1926 is not a proper charge against income of 1927.

(e) Due to adjustment of depreciation, an additional loss of $1,514.29 is allowed on Bethume lease.

(f) Depletion allowed	$110,436.28
Depletion deducted	105,750.38
Additional allowance	$ 4,685.90

[11]

SCHEDULE 2

Computation of Tax

Income Tax

Net income for taxable year	$65,954.94
Income tax at 13½%	8,903.92
Tax previously assessed	none
Additional tax to be assessed	$ 8,903.92

SCHEDULE 3

Year ended December 31, 1928.

Net Income

Net income as disclosed by return		$413,092.09
As corrected		434,357.54
Net adjustment		$ 21,265.45
Unallowable deductions and additional income:		
(a) Sale assets	$ 1,605.54	
(b) Capital stock tax	2,441.00	
(c) Depreciation	22,991.80	
Total		$ 27,038.34

Nontaxable income and additional deductions:		
(d) Loss by abandonment	$ 3,711.57	
(e) Depletion	2,061.32	
Total		$ 5,772.89
Net adjustment as above		$ 21,265.45

Explanation of Items Changed

(a) Profit on sale of miscellaneous equipment is added to income.

(b) Capital stock tax for 1926 is a proper charge against that year's income.

[12]

(c) Depreciation is adjusted as shown in exhibit "D" of revenue agent's report.

(d) Loss on abandonment of property is increased, due to adjustment of depreciation in prior years.

(e) Depletion allowed	$143,585.26
Depletion deducted	141,523.94
Additional deduction	$ 2,061.32

SCHEDULE 4

Computation of Tax

Income Tax

Net income for taxable year	$434,357.54
Income tax at 12%	52,122.90
Tax previously assessed	49,571.05
Additional tax to be assessed	$ 2,551.85

[Endorsed]: Filed Apr. 16, 1931. [13]

[Title of Court and Cause—Docket No. 56484.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the petitioner is a corporation organized under the laws of the State of California, with its principal office at San Francisco, California.

(2) Admits the allegations of paragraph II of the petition.

(3) Admits the allegations of paragraph III of the petition.

(4) Denies the respondent erred in the determination of the deficiencies as alleged in subparagraphs 1 to 7, inclusive, of paragraph IV of the petition, and further denies all the material allegations of fact contained therein.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
HENRY A. COX,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Filed June 1, 1931. [14]

[Title of Court and Causes—Docket Nos. 56484, 72502.]

MOTION FOR LEAVE TO FILE AMENDED PETITIONS

Comes now the above designated petitioner by and through its attorney, A. L. Weil, and moves the Honorable United States Board of Tax Appeals for leave to file the accompanying amended petitions in these cases and to substitute such petitions for the original petitions filed. The amended petitions should be accepted in order to permit the petitioner to submit evidence on the new issue involved in all of the above entitled cases in order to avoid irreparable injury which would be done if the petitioner's income tax cases were decided without giving consideration to the new issue which has not heretofore been raised in the pleadings.

The issue raised in the amended petitions, namely the right of the petitioner to depletion deductions on its interest in natural gas reserves under its casinghead gasoline contracts, is new to these proceedings. The fact that the petitioner was entitled to depletion on its interest in natural gas reserves was not known at the time the original petitions were filed. The petitioner is entitled to percentage depletion on its economic interest in oil and [15] gas wells acquired under its various casinghead gas contracts under the decision of the United States Supreme Court handed down January 9, 1933, in the case of Palmer vs. Bender, and under the terms of a

decision promulgated by the Honorable United States Board of Tax Appeals under date of April 27, 1934, in the case of Signal Gasoline Corporation vs. Commissioner of Internal Revenue. The respondent has knowledge of the fact that during each of the years involved in the above cases, the petitioner received substantial gross and net income from operations under its casinghead gas contracts, this information being set out by the Commissioner in determining the deficiencies which give rise to these proceedings.

WHEREFORE, it is respectfully requested that the motion be granted.

(Signed) A. L. WEIL
Counsel for Petitioner,
Higgins Building,
Los Angeles, California.

[Endorsed]: Filed June 6, 1934. Granted June 8, 1934. [16]

[Title of Court and Cause—Docket No. 56484.]

AMENDED PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:E-3 dated February 20, 1931, and as a basis of its proceeding alleges as follows:

1. That the petitioner is a corporation organized under the laws of the State of California, with its principal office at 256 Montgomery Street, San Francisco, California.

2. The notice of deficiency, a copy of which is attached and marked Exhibit A, was mailed to petitioner as petitioner is informed and believes on February 20, 1931.

3. The tax in controversy is income tax for the taxable periods and in the amounts shown below:

Taxable Period	Amount
Calendar year 1927	$8,903.92
Calendar year 1928	2,551.85
Total	$11,455.77

All of these amounts are in controversy. In addition, [17] petitioner seeks a refund of $37,202.13, for the calendar year 1928.

4. The determination of taxes set forth in said notice of deficiency is based upon the following errors:

(a) In determining taxable net income for each of the taxable years in question, the respondent erroneously disallowed deduction for depreciation of petitioner's depreciable property and equipment as follows:

Taxable Period	Amount
Calendar year 1927	$46,884.66
Calendar year 1928	26,548.70
Total	$73,433.36

(b) In determining taxable net income for the calendar year 1927, the respondent erroneously failed to allow as a deduction from gross income losses sustained on bad debts in the amount of $99,645.63.

(c) In determining taxable net income for each of the calendar years in question, respondent erroneously included as income, profits alleged to have been made on sales of miscellaneous equipment as follows:

Taxable Period	Amount
Calendar year 1927	$1,521.11
Calendar year 1928	1,605.54
Total	$3,126.65

(d) In determining taxable net income for the calendar year 1927, the respondent erroneously disallowed as a deduction from gross income, commission paid on a sale of real estate in the amount of $862.50. [18]

(e) In determining taxable net income for each of the years in question, the respondent erroneously failed to allow as deductions from gross income, depletion deductions to which petitioner is entitled as follows:

Taxable Period	Amount
Calendar year 1927	$109,176.14
Calendar year 1928	161,122.82
Total	$270,298.96

5. The facts upon which petitioner relies as a basis for this proceeding are as follows:

(a) During each of the years involved in this appeal petitioner operated a casinghead gasoline plant situate in the Signal Hill Oil Field in the County of Los Angeles, State of California. On the

portion of the plant that was completed prior to 1928 the question of depreciation has been in controversy in prior years from 1923 to 1926 inclusive, and by final decision of the Board of Tax Appeals on stipulation with the Commissioner in Bankline Oil Company vs. Commissioner of Internal Revenue, Docket Nos. 39424 and 41348, the proper amount of depreciation was fixed at 12½% per annum. This decision has been ignored by the Commissioner in computing depreciation for the years involved in this appeal and in lieu of computing depreciation at the allowable rate in determining taxable net income the respondent computed depreciation on the property in question at the rate of 10% per annum.

(b) During the year 1928 the petitioner erected a new unit on its casinghead gasoline plant at Signal Hill. Based on the prospective life of the properties under which the petitioner has gas contracts, it was estimated that the gas would be [19] exhausted in a period of six years. Accordingly the proper rate of depreciation on this property is 16-2/3% per annum. The respondent in error allowed depreciation on the property in question at the rate of only 10% per annum.

(c) During each of the years involved in this appeal, petitioner sustained depreciation on its oil well equipment situate in the Signal Hill Oil Field on the unit basis, which basis was established in settling petitioner's income tax controversies pending before the Board of Tax Appeals for the years 1923 to 1926 inclusive, as follows:

Taxable Period	Amount
Calendar year 1927	$40,647.54
Calendar year 1928	16,224.68
Total	$56,872.22

In determining petitioner's taxable net income for each of the years in question the respondent erroneously computed depreciation on said oil well equipment at the rate of 10% per annum, thus allowing depreciation for each of the years in question as follows:

Taxable Period	Amount
Calendar year 1927	$19,183.93
Calendar year 1928	24,665.71
Total	$43,849.64

(d) During the calendar year 1927 petitioner sustained a loss in the amount of $373,185.97 on uncollectible notes receivable. The respondent erroneously recomputed the loss to be $272,540.34 and disallowed as a deduction from gross income the difference amounting to $99,645.63. The loss claimed, amounting to $373,185.97, was actually sustained by petitioner [20] during the calendar year 1927 and should be allowed as a deduction from gross income in computing taxable net income.

(e) In rendering its tax returns for each of the years involved in this appeal the petitioner correctly reflected gains and profits realized on sales of miscellaneous equipment. In determining taxable income

for each of the years involved in this appeal the respondent made erroneous recomputations of accrued depreciation on miscellaneous items of equipment disposed of and as a result increased taxable income in the respective amounts of $1,521.11 and $1,605.54 for the years in question.

(f) Petitioner in its income tax returns for the year 1927 claimed a deduction in the amount of $862.50 for a liability incurred and paid as commission on various lots of real estate sold during the year 1926. The respondent disallowed this deduction.

(g) Prior to the year involved in this appeal petitioner acquired a depletable interest in certain natural gas reserves and natural gas producing property situate in the State of California, under the terms of various contracts commonly called casinghead gas contracts. Petitioner installed necessary pipe lines and equipment to enable it to obtain gas from its natural gas reserves and constructed an absorption plant for the purpose of removing gasoline from the natural gas. During the year involved in this appeal a substantial part of petitioner's operating income was attributable to the recovery of natural gas from its interest in gas reserves and the absorption of gasoline from such natural gas.

(h) During each of the years involved in this appeal petitioner is entitled to deduct from gross income in computing taxable net income percentage depletion in the amount of 27½ [21] percent of gross income, provided such amount does not exceed

50 percent of net income derived under casinghead gas contracts from its interest in natural gas reserves. During each of the years petitioner realized gross and net income from gas removed from such natural gas reserves and is entitled to depletion deductions as follows:

Taxable Year	Gross Income	Net Income	Allowable Depletion 27½ Percent of Gross Income	Allowable Depletion 50 Percent of Net Income
Calendar year 1927	$475,466.87	$218,352.28	$130,753.39	$109,176.14
Calendar year 1928	632,247.47	322,245.63	173,868.05	161,122.82

(i) In determining taxable net income for each of the years involved in this appeal respondent failed to deduct or to allow petitioner to deduct depletion from gross income in computing taxable net income.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and determine that the respondent erred as alleged in paragraph (4) above, that the facts alleged in paragraph (5) above are true and correct, and that petitioner is entitled to refunds for the periods as set forth in paragraph (3) above.

(Signed) A. L. WEIL,
Counsel for Petitioner,
Higgins Building,
Los Angeles, California. [22]

AFFIDAVIT.

State of California,
City and County of San Francisco—ss.

W. E. KROPP, being first duly sworn, deposes and says: That he is the secretary of the petitioner; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; that the facts stated are true except as to those matters stated to be on information and belief, and as to those matters he believes it to be true.

(Signed) W. E. KROPP.

Subscribed and sworn to before me this 23rd day of May, 1934.

(Signed) LILLIAN RALSTON,
Notary Public in and for the City and County of San Francisco, State of California.

FOR SIXTY-DAY LETTER SEE ORIGINAL PETITION.

[Endorsed]: Lodged June 6, 1934.

[Endorsed]: Filed June 8, 1934. [23]

[Title of Court and Cause—Docket No. 56484.]

ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue by his attorney, Robert H. Jackson, Assistant General Coun-

sel for the Bureau of Internal Revenue, for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies the allegations contained in subparagraphs (a), (b), (c), (d) and (e) of paragraph 4 of the petition.

5. Denies the allegations contained in subparagraphs (a) to (i), inclusive of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the
Bureau of Internal Revenue.

Of Counsel:
GEORGE D. BRABSON,
Special Attorney,
Bureau of Internal Revenue.
MFH 10/18/34.

[Endorsed]: Lodged Oct. 26, 1934.

[Endorsed]: Filed Oct. 29, 1934. [24]

[Title of Court and Cause—Docket No. 72502.]

APPEAL.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IR:AR:E-4 AMcM-60D, dated April 12, 1933, and for the allowance of a refund, and as a basis of its proceedings alleges as follows:

I.

That the petitioner is a corporation organized under the laws of the State of California, with its principal office at No. 256 Montgomery Street, San Francisco, California.

II.

That the notice of deficiency, a copy of which is attached and marked "Exhibit A" was mailed to petitioner as [25] petitioner is informed and believes on April 12, 1933.

III.

Taxes in controversy are income taxes for the calendar year 1930, there being an alleged deficiency of $5,811.67, and petitioner claims a refund of $21,255.57.

IV.

The determination of the tax set forth in said letter is based on the following errors:

(1) Depreciation on petitioner's casinghead gasoline plant at Signal Hill erected prior to 1928 is computed at the rate of 10% per annum, and should have been computed at the rate of 12½% per annum.

(2) The Commissioner erred in depreciating the equipment on State Permit No. 89 at 4% per annum, amounting to $12,612.05. Petitioner claims depreciation on a unit basis of $ .247344 per barrel, amounting to $89,335.93.

(4) Commissioner erred in depleting oil property on Section 36 at the rate of $ .02243 per barrel. Depletion should have been allowed at the rate of $ .13777, on which there should be an additional allowance for depletion of $4,190.75. [26]

(5) The Commissioner erred in disallowing an exemption from taxation of a net sum of $177,-129.75, on which the tax was $21,255.57, on property produced from a lease held from the State of California.

V.

The facts on which petitioner bases his claim are as follows:

The petitioner operates a casinghead gasoline plant in the Signal Hill Oil Field in the County of Los Angeles, State of California. On the portion of the plant that was completed prior to 1928 the question of depreciation has been in controversy in prior years from 1922 to 1926, inclusive, and by final decision of the Board of Tax Appeals on stipulation with the Commissioner in Bankline Oil Company vs. Commissioner of Internal Revenue, Dockets Nos. 39424 and 41348, the proper amount of depreciation was fixed at 12½% per annum. This decision has been ignored by the Commissioner.

In the year 1928 the petitioner erected a new unit on its plant. Based on the prospective life of the

properties under which this petitioner had contracts, it was computed that the gas would be gone in six years, and the proper rate of depreciation is 16 2/3% per annum.

In the former appeals of the petitioner to the Board of Tax Appeals, in which final decision was rendered in Dockets [27] Nos. 39424 and 41348 on stipulation with the Commissioner the depreciation was allowed on a unit method. The depreciation at 4% allowed by the Commissioner amounts to $12,612.05. The method of depreciating fixed by the decision of the Board of Tax Appeals amounts to $ .247344 per barrel. The production for the year was 361,181 barrels. So depreciation allowed should have been $89,335.93.

In reference to Sec. 36 the depletion, instead of being at the rate of $ .0243 per barrel, should have been at the rate of $ .13777 per barrel. So that the depletion should have been $5,023.80. This is in accordance with a decision rendered by the Board of Tax Appeals in accordance with the Commissioner's stipulation.

The petitioner operates a lease in the Elwood area, County of Santa Barbara, State of California, issued by the State of California on tidelands below the high water mark. The State reserves a 5% royalty from the petitioner in the operation of this lease. The total net revenue derived from said lease during the year in question was $177,129.75. The petitioner paid a tax of $21,255.57 under protest, and in due time, as provided by law, made claim

for refund, which has been disallowed. Petitioner claims that said income is not subject to tax by the United States under a decision of the United States Supreme Court on the ground that said lease is an instrumentality of the State of California. [28]

WHEREFORE, petitioner prays that this Board may hear the proceedings, cancel the overassessment amounting to $5,811.67, and award petitioner a refund of $21,255.57, with interest.

A. L. WEIL,
Counsel for Petitioner,
310 Sansome Street,
San Francisco, California.

State of California,
City and County of San Francisco—ss.

W. E. KROPP, being first duly sworn, deposes and says:

That he is the secretary of the petitioner; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; that the facts stated are true except as to those matters stated to be on information and belief, and as to those matters he believes it to be true.

W. E. KROPP

Subscribed and sworn to before me this 26th day of May, 1933.

[Seal] LILLIAN RALSTON,
Notary Public in and for the City and County of San Francisco, State of California. [29]

EXHIBIT A.

TREASURY DEPARTMENT
Washington

Apr. 12, 1933.

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
and refer to

Bankline Oil Company,
256 Montgomery Street,
San Francisco, California.

Sirs:

You are advised that the determination of your tax liability for the year(s) 1930 discloses a deficiency of $5,811.67, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and prevent-

ing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; WHEREAS IF THIS FORM IS NOT FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By W. T. SHERWOOD,
Acting Deputy Commissioner.

Inclosures:
Statement
Form 870 [30]

IR:AR:E-4
AMcM-60D

STATEMENT.

In re: Bankline Oil Company
256 Montgomery Street,
San Francisco, California.
Income Tax Liability

Year—1930.
Income Tax Liability—$45,762.23.
Income Tax Assessed—$39,950.56.
Deficiency—$5,811.67.

The deficiency shown herein is based upon the report dated April 4, 1932 prepared by Internal Revenue Agent William J. Lyons and transmitted to you under date of April 13, 1932, which report is made a part of this letter.

Inasmuch as no evidence has been submitted in support of your contention that certain income from the operation of a lease held by you from the State of California is exempt from Federal income tax under article 642 of Regulations 74, your claim for refund of $21,255.57 for the year 1930 will be disallowed. Official notice of the disallowance of your claim will be issued by registered mail in accordance with section 1103(a) of the Revenue Act of 1932.

[Endorsed]: Filed June 5, 1933. [31]

[Title of Court and Cause—Docket No. 72502.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations of paragraph I of the petition.

(2) Admits the allegations of paragraph II of the petition.

(3) Admits the allegations of paragraph III of the petition.

(4) Denies the respondent erred in the determination of the deficiency as alleged in subparagraphs (1) to (5), inclusive, of paragraph IV of the petition.

(5) Denies the allegations of fact contained in paragraph V of the petition.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

(Signed) E. BARRETT PRETTYMAN,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
HENRY A. COX,
T. A. DILS,
Special Attorneys,
Bureau of Internal Revenue.

HAC:TAD:I
8/1/33

[Endorsed]: Filed Aug. 3, 1933. [32]

[Title of Court and Cause—Docket No. 72502.]

AMENDED PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IR:AR:E-4 AMcM-60D, dated April 12, 1933, and for the allowance of a refund, and as a basis of its proceedings alleges as follows:

1. That the petitioner is a corporation organized under the laws of the State of California, with its principal office at 256 Montgomery Street, San Francisco, California.

2. That the notice of deficiency, a copy of which is attached and marked Exhibit A was mailed to petitioner as petitioner is informed and believes on April 12, 1933.

3. The tax in controversy is income tax for the calendar year 1930, there being an alleged deficiency in the amount of $5,811.67. The entire amount is in controversy, and in addition petitioner seeks a refund in the amount of $33,710.32.

4. The determination of the tax set forth in said letter is based on the following errors:

(a) Depreciation on petitioner's casinghead gasoline plant at Signal Hill erected prior to 1928 is computed at the rate of 10% per annum, and should have been computed at the [33] rate of 12½% per annum.

(b) Depreciation on the plant erected in 1928 is computed on the basis of 10% per annum instead of at the rate of 16-2/3% per annum.

(c) The Commissioner erred in depreciating the equipment on State Permit No. 89 at 4% per annum, amounting to $12,612.05. Petitioner claims depreciation on a unit basis of $.247344 per barrel, amounting to $89,335.93.

(d) Commissioner erred in depleting oil property on Section 36 at the rate of $.02243 per barrel. Depletion should have been allowed at the rate of $.13777, on which there should be an additional allowance for depletion of $4,190.75.

(e) The Commissioner erred in disallowing an exemption from taxation of a net sum of

$239,299.88, on which the tax as computed amounted to $28,713.98, on income produced from a lease held from the State of California.

(f) In determining taxable net income for the calendar year 1930, the respondent erroneously failed to allow as deductions from gross income depletion deductions to which petitioner is entitled in the amount of $54,641.10.

5. The facts on which petitioner bases his claim are as follows:

(a) The petitioner operates a casinghead gasoline plant in the Signal Hill Oil Fields in the County of Los Angeles, State of California. On the portion of the plant that was completed prior to 1928 the question of depreciation has been in controversy in prior years from 1923 to 1926, inclusive, and by final decision of the Board of Tax Appeals on stipulation with the Commissioner in Bankline Oil Company vs. Commissioner of Internal Revenue, Docket Nos. 39424 and 41348, the proper [34] amount of depreciation was fixed at 12½% per annum. This decision has been ignored by the Commissioner.

(b) In the year 1928 the petitioner erected a new unit on its plant. Based on the prospective life of the properties under which this petitioner had contracts, it was computed that the gas would be gone in six years, and the proper rate of depreciation is 16-2/3% per annum.

(c) In the former appeals of the petitioner to the Board of Tax Appeals, in which final

decision was rendered in Docket Nos. 39424 and 41348 on stipulation with the Commissioner the depreciation was allowed on a unit method. The depreciation at 4% allowed by the Commissioner amounts to $12,612.05. The method of depreciating fixed by the decision of the Board of Tax Appeals amounts to $.247344 per barrel. The production for the year was 361,181 barrels. So depreciation allowed should have been $89,335.93.

(d) In reference to Sec. 36 the depletion, instead of being at the rate of $.0243 per barrel, should have been at the rate of $.13777 per barrel. So that the depletion should have been $5,023.80. This is in accordance with a decision rendered by the Board of Tax Appeals in accordance with the Commissioner's stipulation.

(e) The petitioner operates a lease in the Elwood area, County of Santa Barbara, State of California, issued by the State of California on tidelands below the high water mark. The State reserves a 5% royalty from the petitioner in the operation of this lease. The total net revenue derived from said lease during the year in question was $239,299.88. The petitioner paid a tax of $28,713.98 under protest, and in due time, as provided by law, made claim for refund, which has been disallowed. [35] Petitioner claims that said income is not subject to tax by the United States under a decision of the United States Supreme Court on the ground that said lease is an instrumentality of the State of California.

(f) Prior to the year involved in this appeal petitioner acquired a depletable interest in certain natural gas reserves and natural gas producing property situate in the State of California, under the terms of various contracts commonly called casinghead gas contracts. Petitioner installed necessary pipe lines and equipment to enable it to obtain gas from its natural gas reserves and constructed an absorption plant for the purpose of removing gasoline from the natural gas. During the year involved in this appeal a substantial part of petitioner's operating income was attributable to the recovery of natural gas from its interest in gas reserves and the absorption of gasoline from such natural gas.

(g) During the taxable year involved in this appeal petitioner is entitled to deduct from gross income in computing taxable net income percentage depletion in the amount of 27½% of gross income, provided such amount does not exceed 50% of net income derived under casinghead gas contracts from its interest in natural gas reserves. During the calendar year 1930 petitioner realized gross and net income under its casinghead gas contracts in the respective amounts of $300,017.99 and $109,282.21, and is entitled to a depletion deduction in the amount of $54,641.10 in computing taxable net income. Respondent failed to deduct or to allow petitioner to deduct any part of the depletion sustained on income derived under casinghead gas contracts from gross income in computing taxable net income for the year in question. [36]

WHEREFORE, the petitioner prays that this Board may hear the proceeding and determine that the respondent erred as alleged in paragraph (4) above, and that the facts alleged in paragraph (5) above are true and correct and that petitioner is entitled to a refund for the period as set forth in paragraph (3) above.

(Signed) A. L. WEIL
Counsel for Petitioner,
Higgins Building,
Los Angeles, California. [37]

AFFIDAVIT

State of California
City and County of San Francisco—ss.

W. E. KROPP, being first duly sworn, deposes and says: That he is the secretary of the petitioner; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; that the facts stated are true except as to those matters stated to be on information and belief, and as to those matters he believes it to be true.

(Signed) W. E. KROPP

Subscribed and sworn to before me this 23rd day of May, 1934.

(Signed) LILLIAN RALSTON
Notary Public in and for the City and County of San Francisco, State of California.

For sixty-day letter see original petition.

[Endorsed]: Lodged June 6, 1934.

[Endorsed]: Filed June 8, 1934. [38]

[Title of Court and Cause—Docket No. 72502.]

ANSWER TO AMENDED PETITION

The Commissioner of Internal Revenue by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies the allegations contained in subparagraphs (a) to (f), inclusive of paragraph 4 of the petition.

5. Denies the allegations contained in subparagraphs (a) to (g), inclusive, of paragraph 5 of the petition.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the
Bureau of Internal Revenue.

Of Counsel:
GEORGE D. BRABSON,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Lodged Oct. 26, 1934.

[Title of Court and Causes—Docket Nos. 56484 and 72502.]

Promulgated January 16, 1936.

Income from a lease between the petitioner and the State of California is taxable under the principle of Burnet v. A. T. Jergins Trust, 288 U. S. 508.

Under the facts of this case petitioner has no depletable interest arising out of casinghead gas contracts. Signal Gasoline Corporation, 66 Fed. (2d) 886, distinguished.

A. L. WEIL, Esq., for the petitioner.

GEORGE D. BRABSON, Esq., for the respondent.

The respondent has determined deficiencies in income tax of $8,903.92, $2,551.85, and $5,811.67 for the taxable years 1927, 1928, and 1930, respectively, and the petitioner has brought these proceedings for the redetermination thereof, at the same time claiming overpayment for the latter year of $33,710.32.

Numerous issues were raised by the pleadings but those pertaining to depreciation, bad debts, profit upon the sales of miscellaneous equipment, commission paid upon the sale of real estate, and certain depletion (other than below) have been settled by stipulation of the parties, as hereinafter shown, leaving for our consideration only two issues, (1) whether the petitioner is totally exempt from income tax upon that portion of its income derived from a certain lease between the petitioner and the State of California, and (2) whether the petitioner is entitled to depletion growing out of its operations under so-called casinghead gas contracts.

FINDINGS OF FACT.

The petitioner, a corporation, organized and incorporated under the laws of the State of California, was engaged during each of the taxable years in controversy, and for many years prior thereto, in the business of producing oil from properties in which it owned an interest or in which it had acquired an interest as lessee, and also in the business of producing casinghead gasoline under the terms of various so-called "casinghead gas" contracts. For this latter purpose it maintained and operated, during each of said years, casinghead gasoline plant situated in the Signal Hill Oil Field, of Los Angeles, California. Its books of account were kept and its returns were filed on the accrual basis.

Under what is referred to by the parties as "Lease #89", dated October 22, 1929, the State of California leased certain oil and gas lands situated in the county of Santa Barbara, California, to J. H. Barneson, vice-president and director of the petitioner, who acted as agents for the petitioner, pursuant to the provisions of chapter 303, Statutes of California 1921, approved May 25, 1921, entitled "An Act to Reserve All Minerals in State Lands, etc." Barneson and his wife assigned all their right, title, and interest in said lease to the petitioner on November 14, 1929, and on December 19, 1929, the assignment was duly approved by the State of California.

The petitioner, upon acquiring the aforesaid lease, immediately commenced drilling operations, and since that date it has continuously operated in ac-

cordance with the provisions thereof. In rendering its income tax return for the calendar year 1930, the petitioner, under protest, included in its taxable net income the income attributable to its operations under that lease in the amount of $177,129.75. Due to changes in allowable depreciation and depletion the income attributable to the petitioner's operations under the lease would be reduced from $177,129.75, as reflected in its return, to $139,014.28. The petitioner realized net income from its operations under said lease, during the calendar year 1930, of $139,014.28.

Natural gas, commonly known as "wet gas", as it flows from the earth, is not a salable commodity. It is only through processing—by separation of the gasoline therefrom—rendering it dry, that it may be sold for commercial uses. Conversely, it is only through the separation of dry gas from wet gas that the gasoline is salable. It is this process that produces casinghead gasoline. The content of gasoline in wet gas varies from one-half gallon to six gallons a thousand cubic feet of gas produced, depending upon its richness.

In and prior to the taxable years the petitioner entered into numerous contracts with oil producers for the treatment of "wet gas" by the extraction of gasoline therefrom. Those contracts provided, generally, that the petitioner should install and maintain the necessary pipe lines and connections from casingheads or traps at the mouth of the well to its plant, through which the producer agreed to deliver to the petitioner's plant the natural gas produced at

such well, and that the petitioner should extract the gasoline therefrom, the petitioner to pay the producer 33-1/3 percent of the total gross proceeds derived from the sale of gasoline extracted from wet gas or, at the producer's option, therein provided, to deliver 33-1/3 percent of the salable gasoline, so extracted, to the producer. A slightly different type of such contract provided for the outright "purchase" from the producer of all natural gas produced at a given well, the petitioner paying 33-1/3 percent of the gross proceeds received by it from the sale of gasoline extracted from said gas. Some of the dry gas remaining after removal of the gasoline was blown to the air and wasted because there was no market for it, while some was sold to public utilities, in which case the petitioner accounted to the producer for a proportion of the proceeds provided for under the contract and some was returned to the wells to be used for pressure purposes.

The petitioner first raised the question of depletion under the casinghead gas contracts by amended petition.

OPINION.

Morris: The petitioner seeks total exemption of the income derived during the taxable year 1930 from "Lease #89", between itself and the State of California, under the doctrine of implied immunity, relying primarily upon Burnet v. Coronado Oil & Gas Co., 285 U. S. 393. The respondent, on the other hand, relies upon Burnet v. A. T. Jergins Trust, 288 U. S. 508.

Burnet v. Coronado Oil & Gas Co., supra, arose out of a lease entered into between the State of Oklahoma and Coronado Oil & Gas Co. "By the Enabling Act Congress required as a condition precedent to the admission of Oklahoma into the Union that her Constitution should make provision for common schools; and for their benefit it granted certain lands to the state with the proviso that those valuable for minerals, gas, and oil should not be sold prior to January 1, 1915, but might be leased. Act of June 16, 1906, 34 Stat. 267, 270, 272, 273. The State Constitution (article 11, §1) established a common school system and pledged her faith to preserve the lands so conveyed by the United States as a sacred trust, and to keep the same for the uses and purposes for which they were granted. The Legislature prescribed regulations for leasing and directing payment of the proceeds into the school fund." Burnet v. Coronado Oil & Gas Co., supra. Some of those lands were leased to Coronado Oil & Gas Co., by which the state was to, and did, receive a certain percentage of the gross production of oil and gas produced thereunder. The Court there held that the lease was an "instrumentality of the state for the purpose of carrying out her duty in respect of public schools."

In Burnet v. A. T. Jergins Trust, supra, the city of Long Beach, California, had acquired and held certain acreage for water supply purposes until, in 1922, oil was discovered in the vicinity thereof, when A. T. Jergins Trust was organized under the laws of California to obtain an oil and gas lease upon such lands. It was stipulated in such lease that

the city should receive 40 percent and A. T. Jergins Trust, 60 percent of the proceeds of oil and gas recovered. The taxpayer in that proceeding relied upon Gillespie v. State of Oklahoma, 257 U. S. 501 and Burnet v. Coronado Oil & Gas Co., supra. But the Court said, holding the income taxable, "In both of those cases the sovereign was acting as the trustee of an express trust with regard to the lands leased. In both the burden upon the public use was more definite and direct than in the present case. As said in the Coronado Case, the doctrine of Gillespie v. Oklahoma is to be applied strictly and only in circumstances closely analogous to those which it disclosed."

We find nothing, in principle, to distinguish the instant case from Burnet v. A. T. Jergins Trust, supra. The proposed tax is upon the net income of an independent private corporate entity from any and all sources, not upon the property of the municipality, upon its share of the oil recovered, the lease itself, nor the gross income therefrom. This income is just as remote from any governmental function as it was there. Certainly there is no close analogy between the circumstances of this case and those found in Burnet v. Coronado Oil & Gas Co., supra. Upon this issue we sustain the respondent's determination.

The petitioner alleges and contends that it is entitled to depletion under its casinghead gas contracts and in support of such contention it relies upon Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886, reversing the Board at 25 B. T. A. 861.

Sections 234 and 204 of the Revenue Act of 1926, applicable to allowable deductions and the basis for determining depletion, etc., are as follows:

Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * * *

Sec. 204 (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the

taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

The applicable provisions of the Revenue Act of 1928 are substantially the same as those of the Revenue Act of 1926 quoted above.

In Signal Gasoline Corporation, supra, the petitioner acquired a number of already existing casinghead gas contracts for which it assumed certain obligations, aggregating in excess of $50,000, and it paid cash of $107,488.41, and 450,000 shares of its common capital stock, par value $1.00 a share. There, as here, the petitioner, under its contracts—in many respects similar in terms to the contracts of this petitioner, but differing in many other vital respects—acquired wet gas from producers in the State of California. The contracts here are similar in their aims and objects but they differ widely in their scope of performance. The aims and objects, in both instances, were to produce wet gas and by a process of manufacture to render that wet gas a salable, useful commodity. They were similar in that the petitioner, in each instance, was to acquire, by purchase, leases, or otherwise all of the natural gas produced at a specified well for the purpose of extracting the gasoline therefrom and disposing of it, together with the dry gas—that is, such dry gas as was not consumed in the manufacture or blown to air, for the benefit of the parties concerned in pro-

portion to their contractual interests. In both cases the petitioner was required to lay the necessary pipe lines from the well to the absorption plant and, of course, such rights of ingress and egress as were necessary to the upkeep of such pipe lines were provided for. One noteworthy distinction, however, appears in the fact that in the instant case the producer, not the petitioner, was required to furnish necessary casingheads and gas traps to which the producer agreed to deliver the wet gas and from which the petitioner agreed to convey, through its pipe line, to its plant for treatment. In that case there appears to have been a much greater obligation on the part of the petitioner. Its duties respecting the production of gas did not cease with the delivery of wet gas to the casinghead or gas traps but it was required "whenever it became feasible and advisable, to install a vacuum upon the wells" and furthermore, "that it would install the necessary equipment and maintain such vacuum as was desired" by the producer "for regulating the pressure to be exerted in the operation." The petitioner there "assisted in drilling wells by furnishing separators, casing, derricks, boilers, other drilling equipment on the outcome of the well", for which it "received no payment, if the well was dry." Not only were the producers there bending their efforts toward the production and delivery of gas to the petitioner, but "producers and the petitioner were both engaged in continuous steps to win oil and casing-head gas from their position in the earth."

In that case "After a well had ceased flowing in commercial quantities from the natural pressure, it was necessary, in the case of most of the wells, for petitioner to take direct means by the introduction of high pressure dry gas into the well to induce a larger flow of oil and gas." In the instant case the petitioner was only required to return to the producer such quantity of gas as was necessary for injection purposes—it was required to take no "direct means" to bring about the production of gas—what means it took were indirect and merely incidental to its contractual obligation.

So much for the distinctions between the instant case and the case relied upon by the petitioner to support its claim. Let us examine a contract of this petitioner and see if we are able to find, as the court did there, that the interest of the petitioner was in the nature of a profit a prendre. Unless there was, of course, the petitioner would have no depletable interest. It is clear to our minds that it was intended by these contracts to establish an independent relationship between the parties, the producer, producing wet gas, on the one hand, and the manufacturer, converting that wet gas into salable commodities on the other. The preamble of this typical contract recites that the producer "is the owner of the natural gas produced" under that contract; that the petitioner has erected a plant for the extraction of gasoline; that in order to obtain "an adequate supply of gas for said plant" the petitioner "desires to receive from Producer all of the natural gas which may be produced" under such contract; that the

"Producer is desirous of having the gas produced" under that contract "treated for the extraction of gasoline therefrom", and "as an inducement to Bankline to operate a plant capable of treating the natural gas produced" the producer "is willing and desires to deliver to Bankline all of the natural gas produced."

The body of the contract repeatedly speaks in language of separate and independent obligations of the parties leaving not the slightest suggestion of an intention to create a right of profit a prendre. Speaking of this right, the court in Signal Gasoline Corporation, supra, said: "Considered by themselves, the contracts may not specifically convey any title to gas in the ground, but the contracts confer upon petitioner the right to enter upon the land and connect its pipes directly with the oil wells, install meters, and petitioner is required to maintain vacuums on the oil wells. These provisions, together with the method of operation sanctioned by the parties whereby petitioner, by means of gas lifts, rodless pumps, and the use of compressors to create vacuums, extracted the gas that would otherwise not be produced from the premises, conferred upon it an incorporeal right to be exercised in the land in relation to the gas which was in the nature of a grant of a profit a prendre." The only provision for the use of vacuum, found in only two of these contracts (there being seven), one of which, entered into between the petitioner and the General Petroleum Corporation on June 9, 1922, says:

> The first party [General Petroleum Corporation] hereby agrees to deliver to the second party [petitioner] at the traps or casing-heads of the wells in said Signal Hill District during the life of this agreement as hereinafter set forth, all gas which is now or which may be hereafter produced by the first party from any or all wells located in said Signal Hill District, and the said second party shall have the right to apply such vacuum if any as the first party shall hereafter indicate, and the vacuum to be applied to such wells may be changed from time to time as conditions in such wells warrant, but such change can only be made upon the sanction and consent in writing of said first party.

This provision, however, falls far short of establishing an absolute duty upon the petitioner or an absolute right in it to apply a vacuum without the approval of General Petroleum Corporation. At any rate there is really no proof of record that this contract, which was to continue so long as General Petroleum Corporation had available gas in the Signal Hill District, was actually in force during the years in question. Nor does the other contract in which it is provided for, dated March 23, 1926, alter our conclusion.

The court there was convinced that the contracts under consideration and the "methods employed in reducing the wet gas to possession" created "an interest in the gas in place or a right to share in the gas produced." It concluded that the petitioner

has the "requisite economic interest which under the statute entitled it to reasonable allowances for depletion." We are not so convinced.

There is not sufficient evidence for us to find here, as the court did there, that when the wells were drilled down to sand, only a small portion of the gas rose sufficiently to be caught in the casinghead, nor may we conclude from the evidence before us, as the court did, that "This would amount to such an insignificant quantity we would not have justified the erection of a plant to reduce it." There is some evidence of record from which we may conclude that difficulties were encountered from time to time in forcing the gas to the surface but we can not conclude that this difficulty was of such magnitude as the court there was able to find. Nor may we conclude, assuming the petitioner to have been cognizant of such factors at the outset, that it would not have installed such an extensive plant had not its contract with the producer granted it an interest in the mineral in place or assured it of a portion of the gross proceeds therefrom. It is safe to say, we believe, that this petitioner had no enforceable rights whatsoever under its contracts prior to the time the wet gas was actually placed in its pipe line, i. e., after it had passed beyond the casingheads and gas traps supplied by the producer and into the pipe line, except the right, perhaps, to demand that the producer deliver whatever was produced through its pipe lines for treatment during the period of contractual relationship.

Upon the record, the petitioner has wholly failed to establish depletable interest under the statute.

Even if all other facts, to which we have referred, pointed to a favorable conclusion for the petitioner we are of the opinion that the proof upon the subject of rates falls short of the mark for reasons which we need not discuss. See Lomita Gasoline Co., 33 B. T. A. 385.

Recomputation of the deficiencies, if any, should be in acordance herewith and the stipulation of the parties.

Reviewed by the Board.

Judgment will be entered under Rule 50.

Smith and Murdock concur in the result.

Trammell, Van Fossan, and Arnold dissent.

Black, concurring in the result:

I agree without reservation as to the first point. I concur in the result which has been reached in the majority opinion on the second point but I do so on the ground stated in the concluding paragraph of the opinion to the effect that petitioner has failed to show that the value of wet gas at the mouth of the well purchased under casinghead gasoline contracts was in excess of the royalties paid therefor and therefore has not shown any proper basis for depletion deductions. Signal Gasoline Corporation, 30 B. T. A. 568, affd. C. C. A., 9th Cir., 77 Fed. (2d) 778; Lomita Gasoline Co., 33 B. T. A. 385.

I do not concur in that part of the discussion in the majority opinion which holds that the casinghead gas contracts in the instant case are sufficiently different from those present in Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886, as to make the two cases distinguishable and to justify the holding in the majority opinion that petitioner in the instant case has no depletable interest arising out of the casinghead gas contracts. Petitioner's failure of proof to show what amount of depletion deductions, if any, it is entitled to take, appears to be similar to that in the cases above cited. As the court said in Signal Gasoline Corporation v. Commissioner, 77 Fed. (2d) 778, "Since the taxpayer is seeking a deduction for depletion from its otherwise taxable income, the burden of proof is upon it not only to prove that it is entitled to the deduction but also to prove the correct amount thereof."

Arundell and Leech concur in the above.

Copies served on both parties. [40]

United States Board of Tax Appeals

Docket Nos. 56484, 72502

BANKLINE OIL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

The above-entitled proceeding having been called from the Day Calendar of March 4, 1936 for hearing under Rule 50 pursuant to findings of fact and opinion promulgated January 16, 1936 and it appearing that respondent's recomputation for the years 1927 and 1928 stands uncontested by the petitioner, it is

ORDERED and DECIDED: That for 1927 there is a deficiency of $5,108.71, of which $3,592.88 has been paid; therefore there is now a deficiency for said year of $1,515.83, and it is further

ORDERED and DECIDED: That there is an overpayment for the year 1928 of $65.59, said tax having been paid within two years before the filing of the petition.

[Seal] (Signed) LOGAN MORRIS,
Member

Entered Mar. 24, 1936. [41]

[Title of Court and Cause.]

ORDER.

For cause, it is

ORDERED: That in so far as it pertains to Docket No. 72502, the decision entered March 24, 1936 in the above-entitled proceedings is hereby vacated.

[Seal] (Signed) LOGAN MORRIS,
Member.

Dated, Washington, D. C., March 26, 1936. [42]

United States Board of Tax Appeals

Docket No. 72502

BANKLINE OIL COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION.

The above-entitled proceeding having been called from the Day Calendar of March 4, 1936 for hearing under Rule 50 pursuant to findings of fact and opinion promulgated January 16, 1936 and it appearing that respondent's recomputation for the year 1930 stands uncontested by the petitioner, it is

ORDERED and DECIDED: That for 1930 there

is a deficiency of $846.94, of which $825.33 has been paid; therefore there is now a deficiency for said year of $21.61.

[Seal] (Signed) LOGAN MORRIS,
Member

Entered Mar. 28, 1936. [43]

[Title of Court and Cause.]

PETITION FOR REVIEW AND ASSIGNMENT OF ERRORS.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now BANKLINE OIL COMPANY, a corporation, by its attorneys, A. L. Weil and Martin J. Weil, and respectfully shows:

I.

That petitioner is a corporation incorporated under and by virtue of the laws of the State of California, and files this petition pursuant to the provisions of the Revenue Act of 1926, C. 27, 44 Stat. 9, 109, 110, Sections 1001, 1002 and 1003, as amended by the Act of June 6, 1932, C. 209, Section 1101, 47 Stat. 286, as amended by the Act of June 7, 1934, C. 426, 48 Stat. 926, for review by this court of the decisions of the United States Board of Tax Appeals entered in Docket No. 56484 on March 24, 1936, and in Docket No. 72502 on March 28, 1936, determining that there existed deficiencies

in the tax payments of petitioner [44] in the amount of $5,108.71 for 1927 and $846.94 for 1930; and that there was an overpayment of tax of only the sum of $65.59 for the year 1928 and not an overpayment in the sum of $3,598.04 as contended by petitioner; and that petitioner was not entitled to a refund of $18,828.05, or any part thereof, for the year 1930, which said sum petitioner claims is an overpayment of tax.

These cases all related to the taxes of petitioner, and all involved the right of petitioner to deduct depletion growing out of contracts previously entered into by it for the extraction of casinghead gasoline. In addition to said issue, Docket No. 72502 involved the right of petitioner to exclude from its net income income received by it from property covered by an oil and gas lease in which the State of California was lessor. The cases were consolidated by the Board of Tax Appeals for hearing and decision.

II.

The nature of the controversy is as follows:

A. As to the issue relating to the taxability of income from its oil and gas lease from the State of California:

On October 22, 1929, the State of California leased certain oil and gas lands situated in the County of Santa Barbara, California, to H. J. Barneson, vice president and director of petitioner and agent of petitioner. Pursuant to the provisions of Chapter 303, Statutes of California, 1921, approved May 25,

1921, entitled "An Act to Reserve All Minerals in State Lands, etc.", Barneson and his wife assigned all of [45] their right, title and interest in said lease to petitioner on November 14, 1929, and the said assignment was approved by the State of California on December 19, 1929.

Petitioner operated wells drilled upon the said property and drilled additional wells. During the year 1930 petitioner realized a net income from its operations under said lease of $139,014.28.

The only issue on this point is whether or not such income is properly taxable.

B. As to the issue relating to the right of petitioner to take depletion on its casinghead gasoline contracts:

In 1922, petitioner entered into a contract with General Petroleum Corporation by which petitioner agreed to take wet gas produced from certain designated leases of General Petroleum Corporation and to extract the gasoline therefrom. As consideration for furnishing that wet gas, Bankline agreed to pay to General Petroleum Corporation 33 1/3% of all the gasoline extracted from the gas.

In 1923, petitioner entered into a contract with Superior Oil Company and three contracts with United Oil Company for the processing and treatment of their gas upon the same basis. In 1928, petitioner entered into a similar contract with Richfield Oil Company.

The amount of royalty which natural gas processors were required to pay to producers in order

to secure their gas increased from 33 1/3% in 1923 to 45% in 1927, 47½% in [46] 1928, and 50% in 1930.

The petitioner during all of these years received large quantities of wet gas from the wells operated by the aforesaid persons from which it extracted and received casinghead gasoline.

The amounts so received, the royalty paid, and the going royalty were as follows:

Year	Value of gasoline recovered	Contract royalty	Going royalty	Depletable interest
1927	626,494.68	208,831.67	281,922.61	73,090.94
1928	769,633.55	256,544.33	365,575.94	109,031.61
1930	390,596.48	130,257.68	195,298.24	65,040.56

III.

In the record and proceedings before the Board of Tax Appeals and in the decision and final order of re-determination rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of this petitioner, and petitioner assigns the following errors and each of them which, it avers, occurred in the said record, proceedings and decision and final order of re-determination rendered by the Board of Tax Appeals:

A. As to the issue relating to the taxability of income from its oil and gas lease from the State of California:

1. The Board erred in concluding as a matter of law that the income received by peti-

tioner as a result of its operations on lands owned by the State of California and leased to petitioner was a part of petitioner's income for purposes of [47] income tax and was not exempt from such income tax.

2. The Board erred in failing to find as a fact that petitioner had not erroneously paid taxes upon the sum of $139,014.28, being the net income received by petitioner as a result of its operations upon lands owned by the State of California and leased to petitioner.

3. The Board erred in holding that there was no overpayment of tax by petitioner for the year 1930.

4. The Board erred in failing to hold that petitioner had overpaid its taxes for 1930 in the sum of $16,681.71 because of its payment of taxes upon the income received by petitioner from its operations on lands owned by the State of California and leased to petitioner.

B. As to the issue relating to the right of petitioner to take depletion on its casinghead gasoline contracts:

1. The Board erred in failing to hold that petitioner was entitled to deduct the sum of $73,090.94 for depletion on its casinghead gasoline contracts for the year 1927.

2. The Board erred in failing to hold that petitioner was entitled to deduct the sum of

$109,031.61 for depletion on its casinghead gasoline contracts for the year 1928.

3. The Board erred in failing to hold that petitioner was entitled to deduct the sum of $65,040.56 for depletion on its casinghead gasoline contracts for the year 1930.

4. The Board erred in concluding as a matter of law that the contracts between petitioner and various producers to [48] extract casinghead gasoline produced by such producers with their oil, did not give to petitioner a depletable interest in the gas so produced when the going rate of royalty increased.

5. The Board erred in failing to hold that by virtue of the increase in the going rates of royalty upon casinghead gasoline contracts, petitioner under its casinghead gasoline contracts acquired a depletable interest measured by the difference between the royalty petitioner was required to pay and the royalty as determined by the going rate of royalty for the year in question.

6. The Board erred in holding in effect that there was no evidence to support a finding as to the amounts of depletion to which petitioner was entitled for the years 1927, 1928 and 1930, and each of them.

7. The Board erred in holding that there was a deficiency in petitioner's tax for the year 1927 in the sum of $5,108.71, or any part thereof.

8. The Board erred in holding that for the year 1928 petitioner had overpaid its taxes only to the extent of $65.59, and that petitioner had not overpaid its taxes in the sum of $3,598.04.

9. The Board erred in holding that there was a deficiency in petitioner's tax for the year 1930 in the sum of $846.94, and in failing to hold that there was an overpayment as a result of this issue in the sum of $2,146.34. [49]

WHEREFORE, your petitioner, Bankline Oil Company, petitions that the decisions of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with law and the rules of said court and transmitted to the clerk of said court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said court.

Dated: June 19, 1936.

A. L. WEIL
MARTIN J. WEIL
Attorneys for Petitioner [50]

State of California
County of Los Angeles—ss.

E. J. CASE, being first duly sworn, deposes and says: That he is an officer, to-wit, Assistant Secretary, of petitioner Bankline Oil Company, and as such is duly authorized to verify the foregoing peti-

tion for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

E. J. CASE.

Subscribed and sworn to before me this 19th day of June, 1936.

[Seal] (s) NINA M. BROCKUS,
Notary Public in and for the County of Los Angeles, State of California

[Endorsed]: Filed June 23, 1936. [51]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To Herman Oliphant, Esq., and
George D. Brabson, Esq.,
Bureau of Internal Revenue,
Washington, D. C.

You are hereby notified that Bankline Oil Company, petitioner in the above entitled action, did on the 23 day of June, 1936, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board heretofore rendered in the above entitled case. A copy of

the petition for review and the assignment of errors as filed is hereby attached and served upon you.

A. L. WEIL
MARTIN J. WEIL
Attorneys for Petitioner.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignment of errors mentioned therein, is hereby acknowledged this 23rd day of June, 1936.

HERMAN OLIPHANT
Attorney for Respondent

[Endorsed]: Filed June 23, 1936. [52]

[Title of Court and Cause.]

STATEMENT OF EVIDENCE

The following is a statement of evidence in narrative form in the above entitled causes. These causes came on before the Honorable Logan Morris, Member of the United States Board of Tax Appeals in San Francisco, California, on July 23, 1934. A. L. Weil, Esq., appeared on behalf of the petitioner, and Robert H. Jackson, General Counsel of the Bureau of Internal Revenue, and George D. Brabson, Special Attorney, Bureau of Internal Revenue, appeared for the respondent.

(1)

The following stipulation covering all of the facts on all issues, but those upon the question of depletion upon casinghead gasoline contracts having previously been entered into by and between counsel for petitioner and counsel for the Government, was thereupon filed: [53]

"STIPULATION OF FACTS

"It is hereby stipulated and agreed by and between the parties hereto that the following facts are true and may be accepted by the Board as facts in arriving at its decision in this proceeding:

1. Petitioner is a corporation organized and existing under the laws of the State of California with its principal office at 256 Montgomery Street, San Francisco, California. For each of the calendar years 1927, 1928, and 1930, and for many years prior thereto, petitioner kept its books and filed its income tax returns on the accrual basis.

Depreciation

2. During each of the taxable years 1927, 1928, and 1930, and for many years prior thereto, petitioner was engaged in the business of producing oil from properties in which it owned an interest or had acquired an interest as lessee; it was also engaged in the business of producing casinghead gasoline under the terms of various casinghead gas contracts and for this purpose petitioner maintained and operated during each of the years mentioned

casinghead gasoline plants situated in the Signal Hill Oil Field in the City and County of Los Angeles, State of California. In rendering its income tax returns for the calendar years 1927, 1928, and 1930, petitioner claimed as deductions from gross income in computing taxable net income depreciation on its depreciable properties as follows: Calendar year 1927, $163,372.03, calendar year 1928, $131,-419.10, and calendar year 1930, $163,372.68. In determining the deficiency set forth in the respective notices of deficiency, the Commissioner allowed as deductions from petitioner's gross income in computing taxable net income depreciation on its said depreciable properties as follows: Calendar year 1927, $87,993.48, calendar year 1928, $108,427.30, and calendar year 1930, $135,429.78. It is agreed that petitioner suffered allowable depreciation on its said depreciable properties for each of the years involved in this proceeding as follows: Calendar year 1927, $132,225.89, calendar year 1928, $122,429.78, and calendar year 1930, $182,144.49, and that petitioner is entitled to deduct from gross income in determining taxable net income for the calendar years 1927, 1928, and 1930, depreciation in the respective amounts of $132,225.89, $122,429.78 and $182,144.49.

Depletion on Oil Properties

3. It is agreed that petitioner suffered allowable depletion on its interest in oil producing properties for each of the years [54] involved in this proceed-

ing as follows: Calendar year 1927, $110,413.93, calendar year 1928, $159,750.28, and calendar year 1930, $212,181.20, and that petitioner is entitled to deduct from gross income in determining taxable net income for the calendar years 1927, 1928 and 1930, depletion in the respective amounts of $110,413.93, $159,750.28, and $212,1881.20. The above agreed allowances for depletion do not include any depletion on petitioner's interest, if any, in oil and gas reserves under its various casinghead gas contracts. It is therefore agreed that if the Board should allow or find that petitioner is entitled to any percentage depletion on income obtained under said casinghead gas contracts that said depletion should be added to the above allowances for depletion on oil properties as above set forth. In determining the deficiency set forth in the respective notices of deficiency, the Commissioner allowed as deductions from petitioner's gross income in computing taxable net income for the calendar years 1927, 1928, and 1930, depletion on its interest in oil producting properties in the respective amounts of $110,436.28, $143,585.26 and $216,932.39. The Commissioner did not allow depletion on the petitioner's interest in oil and gas producing properties under its various casinghead gas contracts.

Profit on Equipment Sales

4. In determining the deficiency set forth in the notices of deficiency covering the calendar years 1927 and 1928, the Commissioner increased peti-

tioner's taxable net income as reported in its income tax returns for each of those years by adding thereto profits on sales of miscellaneous equipment as follows: Calendar year 1927, $1,521.11 and calendar year 1928, $1,605.54. It is agreed that said adjustments made by the Commissioner are correct.

Commission on Sales of Real Estate

5. In determining the deficiency set forth in the notice of deficiency covering the calendar year 1927, the Commissioner increased taxable net income as reported on petitioner's income tax return for that year in the amount of $862.50 by disallowing as a deduction from gross income commissions paid on sales of real estate amounting to $862.50. It is agreed that said adjustment made by the Commissioner is correct.

Losses on Notes Receivable

6. In rendering its income tax return for the calendar year 1927, petitioner claimed as a deduction from gross income in computing taxable net income a loss in the amount of $373,185.97 on uncollectible notes receivable. The Commissioner recomputed the [55] loss sustained on uncollectible notes receivable and allowed as a deduction from petitioner's gross income a loss in the amount of $273,-540.34, thus disallowing as a deduction from gross income the difference amounting to $99,645.63. It is agreed that petitioner suffered an allowable loss on said uncollectible notes receivable during the calen-

dar year 1927 in the amount of $273,540.34, and that the adjustment made by the Commissioner in disallowing $99,645.63 of the loss claimed in petitioner's tax return is correct.

Losses on Abandonment

7. In determining the deficiency set forth in the notice of deficiency covering the calendar years 1927 and 1928, the Commissioner allowed as deductions from gross income in computing taxable net income losses sustained on certain abandoned leases as follows: Calendar year 1927, $25,312.38, and calendar year 1928, $24,770.69. In determining said losses, the Commissioner did not take into consideration depreciation allowable on the abandoned development and equipment on the basis of the settlement of petitioner's income tax controversies for the calendar years 1923 to 1926, inclusive. Petitioner sustained losses on the aforesaid abandoned leases as follows: Calendar year 1927, $9,214.94, and calendar year 1928, $16,415.24, and losses previously allowed by the Commissioner on abandoned leases for the calendar years 1927 and 1928 should be reduced in the respective amounts of $16,087.44 and $8,355.45.

Losses on Sales of Equipment

8. Due to a revision of depreciation rates, losses on the sale of capital assets allowed by the Commissioner in his deficiency notice covering the calendar year 1930 should be reduced in the amount of $590.83.

9. It is agreed that the adjustments to petitioner's taxable income for the calendar years 1927, 1928 and 1930, as outlined in the preceding paragraphs numbered 1 to 8, inclusive, reduce petitioner's taxable net income as determined by Commissioner in his notices of deficiency as follows: Calendar year 1927, $28,112.62, calendar year 1928, $21,812.02, and calendar year 1930, $41,372.76.

Income from State Lease Number 89

10. Under date of October 22, 1929, the State of California leased certain oil and gas lands pursuant to the provisions of Chapter 303, Statutes of California 1921, approved May 25, 1921, entitled 'An Act to Reserve All Minerals in State Lands, etc.,' situated in the County of Santa Barbara, State of California, to H. J. Barneson. The lease in question is known as Lease #89 [56] and is referred to by the taxpayer as the Elwood Lease. Mr. H. J. Barneson was, on October 22, 1929, the vice-president and director of the petitioner corporation and in acquiring said lease from the State of California, he was acting for petitioner. Under date of November 14, 1929, H. J. Barneson and his wife, Nancy Lee Barneson, assigned all their right, title and interest in the aforesaid lease to Bankline Oil Company. The assignment was duly approved by the State of California under date of December 19, 1929.

11. The petitioner corporation, on acquiring the aforesaid lease immediately commenced drilling operations and since that date has continuously op-

erated in accordance with the provisions of said lease. In rendering its income tax return for the calendar year 1930, the taxpayer, under protest, included in its taxable net income income attributable to its operations under the aforesaid lease in the amount of $177,129.75. Due to changes in allowable depreciation and depletion above set forth, the income attributable to the taxpayer's operations under said lease would be reduced from $177,129.75 as reflected in its income tax return, to $139,014.28. It is agreed that taxpayer realized net income from its operation under said lease during the calendar year 1930 in the amount of $139,014.28. The determination of net income is reflected in Exhibit 1 which is attached to this Stipulation of Facts.

It is further agreed that either party may introduce additional evidence at the hearing before the Board, relating to the issues involved in this proceeding, and not inconsistent with the facts herein stipulated.

(Signed) A. L. WEIL,
Counsel for Petitioner,
Higgins Building,
Los Angeles, California.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for
the Bureau of Internal Revenue,
Counsel for the Respondent.

[57]

[Title of Court and Causes—Docket Nos. 56484, 72502.]

EXHIBIT 1.

STATEMENT SHOWING INCOME ATTRIBUTABLE TO OPERATIONS UNDER STATE LEASE NUMBER 89 DURING THE CALENDAR YEAR 1930.

Net income after deducting royalties		$537,859.88
Less expenses:		
Production expenses	$ 35,614.01	
Taxes	15,572.03	
Overhead	19,088.75	
Depreciation	89,335.93	
Drilling expenses	100,220.61	259,831.33
Net income before deducting depletion		$278,028.55
Less depletion 50% net income		139,014.27
NET INCOME FROM OPERATIONS UNDER THE PROVISIONS OF LEASE NUMBER 89, COVERING OIL LANDS OWNED BY THE STATE OF CALIFORNIA		$139,014.28

[58]

(2)

Statement of Evidence on the Issue Relating to the Right of Petitioner to Take Depletion Upon Casinghead Gasoline Contracts Held By It.

LLOYD AUBERT

being first duly sworn, testified on behalf of petitioner as follows:

I reside in Beverly Hills, California. I am General Manager of The Norwalk Company and the Bankline Oil Company.

(Testimony of Lloyd Aubert.)

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT 1

a contract between Bankline Oil Company and Richfield Oil Company, dated October 9, 1928, reading as follows:

"AGREEMENT

THIS AGREEMENT, made and entered into this 9th day of October, 1928, by and between BANKLINE OIL COMPANY, a California corporation, hereinafter designated as 'Bankline', and RICHFIELD OIL COMPANY OF CALIFORNIA, a Delaware corporation, hereinafter designated as 'Producer',

WITNESSETH:

THAT, WHEREAS, Producer is the owner and/or lessee of those certain parcels of land, situate in the Signal Hill oil district, Los Angeles County, California, described as follows, to-wit:

Lots 3 to 9; Lots 16 to 20; Lots 25 to 29; Lots 35 to 48, all inclusive, in Block 12, Hillside Addition;

Lots 5 to 18, and Lots 27 to 48, both inclusive, in said Block 11, Hillside Addition, County of Los Angeles, State of California, as per map recorded in Book 10, at page 200 of Maps, Records of said county and state.

WHEREAS, producer is the owner and/or lessee of the above described premises and is the owner of

(Testimony of Lloyd Aubert.)

the natural gas [59] produced therefrom and hereby guarantees its right and title to same; and

WHEREAS, Bankline has erected and is operating a plant or plants in the Signal Hill Field for the purpose of treating gas for the extraction of gasoline therefrom; and

WHEREAS, Bankline, in order to obtain an adequate supply of gas for said plant or plants desires to receive from Producer all of the natural gas which may be produced from the above described property; and

WHEREAS, Producer is desirous of having the gas produced from the above described property treated for the extraction of gasoline therefrom; and

WHEREAS, Producer, as an inducement to Bankline to operate a plant capable of treating the natural gas produced from the above described property, is willing and desires to deliver to Bankline all of the natural gas produced on the above described property during the term of this agreement.

NOW, THEREFORE, in consideration of the premises, and of the covenants, agreements and payments hereinafter set forth and other valuable considerations, the receipt of which is hereby acknowledged, the parties hereto covenant and agree with each other as follows:

1. Producer hereby agrees to furnish and deliver to Bankline and Bankline agrees to take and utilize

(Testimony of Lloyd Aubert.)

in its plant or plants, subject to the terms and conditions of this agreement, natural gas produced from the above mentioned property during the life of this agreement except as provided in Paragraphs 7 and 8 hereof.

2. All gasoline condensed in the lines, pumps or traps of said Producer shall be considered as a part of the gas to be delivered to Bankline and shall be accounted for by Bankline as gasoline extracted from said gas.

3. Bankline is granted the exclusive right to treat gas produced from the above described property for and during the period of this agreement.

4. Producer shall deliver the gas at the casing-heads and/or at gas traps installed by Producer on the premises above described. Producer agrees to use its best efforts to prevent the inleakage of air in traps or lines. Bankline shall furnish, install and maintain all pipe lines and connections from casing-heads or traps to its plant or plants and such meters as may be necessary for the accurate measurement of the gas received from the property. [60]

5. The Producer, insofar as it has the right to do so, shall furnish rights of way for such pipe lines and connections on the property. Producer hereby grants to Bankline a right of way for its employees and vehicles over and across the lands of Producer hereinabove described for any and all purposes necessary or proper in connection with the business of Bankline insofar as it pertains to the functions to be performed by Bankline under the terms of this

(Testimony of Lloyd Aubert.)

agreement. Bankline shall be entitled to remove, within a reasonable time after the termination of this agreement, all pipe lines, connections, meters and other equipment installed by it.

6. In full consideration of the rights herein granted, Bankline agrees to pay to Producer thirty-three and one-third per cent (33-1/3%) of the total gross proceeds derived at the plant, from the sale of gasoline extracted from wet gas taken from the above described property, or at Producer's option, upon thirty (30) days advance notice in writing, Bankline agrees to deliver thirty-three and one-third per cent (33-1/3%) of the total net salable gasoline extracted from wet gas taken from the above described property to Producer in kind. An option once exercised to take the royalty gasoline either in cash or in kind shall not be changed for at least six (6) months unless agreed to by both parties hereto. In event no notice is given, royalty shall be deemed payable in money.

In the event no sale is made, at the plant, if said gasoline or Bankline uses the same in its refinery or other operations, Bankline agrees that the price of absorption gasoline for royalty settlement purposes hereunder shall be the average current market price offered for absorption gasoline of like quality by Bankline in the Signal Hill District. In event Producer is able to obtain a higher price for its royalty gasoline than is offered by Bankline, then Producer shall have the right, on twenty-four (24) hours written notice, to immediately exercise its

(Testimony of Lloyd Aubert.)

option to thereafter take its royalty gasoline in kind for a period of six (6) months as above set forth.

In event royalty gasoline shall be paid in kind, Bankline shall provide ten (10) days free storage of the royalty gasoline belonging to Producer in tanks provided by Bankline, provided, however, that such storage shall be at Producer's risk as to all loss by evaporation, fire and/or other causes beyond the reasonable control of Bankline.

Royalty payments shall be made by Bankline to Producer on or before the 20th of each calendar month next succeeding that in which the gasoline is produced.

7. It is understood that Producer is operating its property primarily for oil production and Bankline agrees to [61] handle the gas produced from Producer's property at pressures which, in the opinion of Producer, will not interfere with the production of oil from the leases. It is understood and agreed by and between the parties hereto that during the period of flush production or in event producer insists on maintaining extremely low pressures on casingheads or gas traps, Bankline shall entail no obligation to take, treat, or pay for gas produced and/or vented during such periods.

Bankline shall not be obligated to treat gas hereunder when the quantity of gas produced is so small as to render the treatment of same unprofitable to Bankline.

(Testimony of Lloyd Aubert.)

Such failure on the part of Bankline to treat gas because of the above mentioned conditions, shall in no manner serve or be considered a repudiation of this agreement by Bankline and all of the terms and conditions of this agreement shall be in effect upon resumption of normal operating conditions.

8. Bankline shall not be obligated to utilize any gas in its plant or plants which contains less than five-tenths (5/10) of a gallon of gasoline per one thousand (1,000) cubic feet of gas unless Bankline so desires. In the event Bankline shall refuse or neglect to take and utilize in its plant or plants any gas available on the above described property for the reason that the gasoline content of the gas is less than five-tenths (5/10) of a gallon per one thousand (1,000) cubic feet, Bankline agrees to use its best efforts and reserves the right to dispose of such gas in the same manner as provided for handling the residue dry gas from the plant or plants.

9. Bankline shall be entitled to treat at and by means of said plant or plants such quantities of gas as it may desire to take from other producers. Bankline shall meter separately the gas received from Producer and from other producers whose gas is so taken and at least twice a month shall test separately, according to a recognized method for testing gas, samples of gas received from Producer and from other producers. The amount of gasoline extracted from gas delivered by Producer shall be determined as a proportion of the total net gasoline extracted at

(Testimony of Lloyd Aubert.)

such plant or plants, computed from said meter readings and said tests.

10. Bankline agrees to return to Producer at the property line nearest to the existing dry lines of Bankline as much of the residue dry gas credited to Producer as may be necessary for fuel purposes and other producing activities of Producer on the said premises, provided, however, that Bankline shall not be obligated to deliver such gas at a pressure exceeding twenty (20) pounds per square inch at the plant of Bankline [62] making such delivery. It is understood and agred that Bankline may deliver dry gas to Producer in excess of the amount of residue dry gas credited to Producer, but in such event, Producer hereby agrees to pay Bankline for the excess dry gas delivered at the current market price of residue dry gas sold or delivered fom the plant of Bankline making such delivery to Producer, or in event Bankline, in order to meet the dry gas requirements of Producer, is required to purchase dry gas in the open market, then in this event, Producer agrees to reimburse Bankline for the excess dry gas furnished to Producer, at the same price Bankline is required to pay for same.

11. It is mutually understood and agreed that Bankline shall be entitled to use, free of charge, in its plant operations as much gas as it may require, provided, however, that in no event shall it be entitled to use, free of charge, (unless there be no market at the plant for such residue gas), an

(Testimony of Lloyd Aubert.)

amount of dry gas in its plant operations that is greater than twenty-five percent (25%) of the total volume of wet gas received from Producer. It is further mutually understood and agreed that Bankline, at its option, at such time or times as, in its opinion, conditions may warrant, shall be entitled to make a deduction from the quantity of wet gas furnished hereunder, of a certain volume of gas to cover shrinkage of the gas due to the extraction of the gasoline content therefrom; provided, however, that in no event shall the deduction to cover shrinkage of the gas be greater than fifty (50) cubic feet of gas for each gallon of gasoline extracted from gas furnished hereunder. Of the dry gas so computed to remain after the deductions have been made as described above for plant operations and shrinkage, Bankline shall currently return, upon demand of Producer, all or any part thereof to the above described property for use in the development and operation of same.

In the event that Producer does not require all of the gas to be returned for the above mentioned purposes, then Bankline will use its best efforts to sell the balance of the dry gas at the highest price which it can obtain. In the event of the sale of such residue dry gas by Bankline, Bankline shall pay unto Producer, on or before the 20th day of the next succeeding calendar month following that in which the sale occurs, fifty per cent (50%) of the total gross proceeds derived by Bankline from the sale of such residue dry gas, provided, however, that in

(Testimony of Lloyd Aubert.)

the event Bankline is not able to sell the resulting dry gas or for any other reason fails and/or neglects to sell the resulting dry gas, then in such an event Bankline shall be under no obligations whatsoever to Producer with respect to said dry gas.

12. Producer shall at all reasonable times during business hours have access to the accounts and records of Bankline insofar as they pertain to matters arising under this agreement or for the purpose of verifying statements made hereunder. [63]

13. Producer shall be entitled to require Bankline to test meters at intervals of at least once each month and oftener in event same is necessary. Producer shall have the privilege, if it so desires, of being present or having a representative present during all testing of the gas or the checking of meters registering the gas from the above described property.

14. Bankline agrees to furnish Producer with a report not later than the 20th of each month accounting for the gasoline produced and the dry gas returned for lease operations or sold. It is agreed that any and all objections to such reports must be made to Bankline in writing not later than fifteen (15) days after the receipt thereof by Producer, and that the failure by Producer to make such objection in writing within said period of fifteen (15) days shall create a conclusive presumption that such report is correct in all particulars, and that after said fifteen (15) day period shall have elapsed without any such written objections having

(Testimony of Lloyd Aubert.)

been made to Bankline, Producer shall not thereafter have the right to question or dispute such report in any way.

15. In the event that at any time or from time to time Bankline is required to pay any tax, license or governmental charge, directly or indirectly, upon that part of the gasoline manufactured from the gas of Producer to which Producer is entitled as royalty or upon the proceeds of the sale of such royalty gasoline, Producer shall reimburse Bankline for the full amount of such tax, license or governmental charge so paid by Bankline.

16. Bankline agrees to promptly pay, before the same become delinquent, all taxes which may be assessed or levied during the term of this agreement upon any property erected, placed or maintained by Bankline upon any of the lands of producer hereinabove described. In the event that Bankline fails so to do, Producer may pay any such tax, and Bankline shall reimburse Producer for all amounts so paid, with interest from the date of such payment at hte rate of ten per cent (10%) per annum, upon demand being made therefor.

17. Bankline shall not suffer any lien or liens to be filed against the plants, pipe lines, machinery and equipment, or any other property placed by Bankline upon the lands of Producer for work, labor, material or supplies furnished in connection therewith, and if any such lien or liens is filed thereon, Bankline agrees to remove the same at its own ex-

(Testimony of Lloyd Aubert.)

pense and cost and shall pay any judgments which may be entered thereon or thereunder. Should Bankline fail, neglect, or refuse so to do, Producer shall have the right to pay any amount required [64] to release any such lien or to defend any action brought thereon, and to pay any judgment entered therein, and Bankline shall be liable to Producer for all costs, damages and counsel fees, and any amounts expended in defending any proceedings or the payment of any of said liens or any judgment obtained therefor.

18. The non-performance by either party of its obligations hereunder shall be excused so long and only to the extent that such performance is prevented by strikes, delays of transportation companies, or other causes beyond the reasonable control of such party, whether similar or dissimilar to those above stated.

19. It is understood and agreed that in the determining of any question of fact or dispute as to any matter which may arise under this contract, the same shall be determined by a board of arbitrators to be composed of one member appointed by Producer and one member appointed by Bankline, and these two persons shall appoint a disinterested third person, and the decision of the majority of the board of arbitrators shall be binding upon both parties hereto. The decision of the arbitrators shall be a condition precedent to the right of action in this contract.

(Testimony of Lloyd Aubert.)

20. No provision of this contract shall be interpreted contrary to the rules and regulations of any regulatory body of the United States or of the State of California.

21. The term of this agreement shall be for five (5) years from and after the date hereof and so long thereafter as gas may be produced in paying quantities from the above described property.

22. In case of default by either party in the performance of its obligations hereunder, and the continuance of such default for thirty (30) days after written notice thereof, specifying the particulars of the default, the party not in default shall be entitled to terminate or suspend this agreement, and all rights and obligations hereunder shall thereupon cease and determine or be suspended accordingly.

23. All notices from Producer to Bankline shall be sent by United States Mail, postage prepaid, addressed to the Bankline Oil Company, Board of Trade Building, 111 West 7th Street, Los Angeles, California. All notices from Bankline to Producer shall be likewise sent by United States Mail, postage prepaid, addressed to Richfield Oil Company of California, Eleventh Floor, Bartlett Building, Seventh and Spring Streets, Los Angeles, California. Either party may change its mailing address to any other point within the State of California.

24. In so far as the land specifically above described is concerned, this contract wholly supple-

(Testimony of Lloyd Aubert.)

ments, supersedes, takes [65] the place of and forever cancels and renders null and void the following: That certain instrument headed "AGREEMENT, made and entered into the ninth day of June, 1922, by and between the General Petroleum Corporation, a California corporation, First Party, and Bankline Oil Company, likewise a California corporation, Second Party", it being understood that the Bankline Oil Company herein has heretofore treated and in the future intends to treat gas from the properties covered by said conract, the same being now owned by the Producer herein as successor to General Petroleum Corporation interests; and in further consideration of the execution hereof by Bankline Oil Company, the producer hereby releases, remises and forever quitclaims unto said Bankline Oil Company, and to its proprietary and subsidiary companies, all manner of actions and all premises, claims and debts of any kind and description at any time existing in connection with the operations and business conducted under and by virtue of said above described instrument, in so far as said land is concerned, in writing down to October 9th, 1928.

25. This agreement shall continue in force and be binding upon the parties hereto, their heirs, executors, administrators, successors, and assigns, for and during the term and period of this agreement.

(Testimony of Lloyd Aubert.)

IN WITNESS WHEREOF, the parties hereto have hereunto set their signatures and seals the day and year first above written.

BANKLINE OIL COMPANY,
By (s) H. J. BARNESON,
Vice President.
By (s) W. E. KROPP,
Secretary.

Approved
E. L. T.

RICHFIELD OIL COMPANY
OF CALIFORNIA,
By (s) J. G. WALLACE,
Vice President.
By (s) C. A. MADARY,
Secretary.

Approved 1928
(S) H. R. Linhoff

Approved
By (s) S. F. Arto. [66]

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT NO. 2

a contract entered into between Bankline Oil Company and United Oil Company, dated October 25, 1923, reading as follows:

THIS AGREEMENT, made and entered into this 25th day of October, 1923, by and between THE

(Testimony of Lloyd Aubert.)

UNITED OIL COMPANY, a California Corporation, hereinafter designated as "Producer", and BANKLINE OIL COMPANY, a California corporation, hereinafter designated as "Bankline",

WITNESSETH:

THAT WHEREAS, the Producer is the lessee of the hereinafter described premises, generally known as the Jones Lease, under an oil and gas lease from Jonah & Lena B. Jones and John W. & Ora Hevener as lessors, dated July 21st, 1921, and recorded in Book 876, of Official Records, at page 174 thereof, records of Los Angeles County, California; and,

WHEREAS, Bankline has erected a plant in the Signal Hill District, in said County of Los Angeles, capable of handling and treating gas for the extraction of gasoline therefrom; and,

WHEREAS, the Bankline, in order to augment its supply of gas for said plant, desires to purchase and receive from said Producer all of the natural gas (except an aggregate total of three million standard cubic feet per day of twenty-four hours to be retained by Producer from the group of leases known as Denni No. 1, Denni No. 2, and Jones, for the operation of the Signal Hill Gasoline Company's plant) which may be produced from the property hereinafter described, for the purpose of manufacturing and extracting gasoline therefrom. It is expressly agreed that the Producer will install and maintain at its own expense a meter capable of accurately measuring the gas produced from the

(Testimony of Lloyd Aubert.)

property for the purpose of measuring the volume of gas retained by the Producer for the operation of the Signal Hill Gasoline Company's plant. Monthly statements shall be furnished by the Producer, to Bankline of the amount of gas so retained, and Bankline shall be entitled at all reasonable times to inspect said meter. Should any gas in excess of nine million cubic feet in any consecutive three days be reserved by the Producer, the Bankline may elect to immediately cancel this contract, and thereupon all its obligations hereunder shall cease, subject, [67] however, to the provisions of paragraph "14" hereof.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto covenant and agree with each other as follows, to-wit:

1. The Producer hereby agrees to furnish and deliver to the Bankline, for the purpose of manufacturing and extracting gasoline therefrom, all of the gas (except such gas as is excepted above) for and during the entire period of time that gas shall be produced therefrom, the said Bankline being given the exclusive right to treat all gas produced as aforesaid by the Producer (except such gas as was excepted above); subject, however, to any qualifications set forth in paragraph "14" hereof.

2. The Producer shall deliver the gas at a modern and well equipped gas-trap, to be installed and maintained by the Producer at a central point on the premises hereinafter described. Bankline shall

(Testimony of Lloyd Aubert.)

furnish, install and maintain necessary pipe connections from said gas-trap to said plant, and one or more meters for the measurement of gas received at said plant. The connections and meters shall be available to inspection by the Producer at all reasonable times. The Producer shall furnish right of way for said pipe connection on the premises hereinafter described, and the Bankline elsewhere. The Bankline shall be entitled to remove on termination of this agreement all pipe connections, meters and other equipment installed by it.

3. In full consideration of the rights granted the Bankline agrees to pay to Producer one-third (33-1/3%) of the gross proceeds received by it from the sales of gasoline manufactured or extracted from said gas. Bankline shall have the right to sell royalty gasoline with its own share of the product and continue to do so if no election is made by the Producer to take his royalty gasoline in kind. Producer shall have the right to take his royalty gasoline in kind, provided he shall in such event serve Bankline with thirty days' advance notice in writing of such intention; and such election to take royalty gasoline in kind shall be exercised not oftener than once in every six calendar months.

In the event royalty gasoline is paid in kind, Producer shall be entitled to ten days' free storage of his royalty gasoline in tanks provided by Bankline, provided that such storage shall be at Producer's sole risk as to loss by evaporation, fire, or any other cause.

(Testimony of Lloyd Aubert.)

4. Royalty payments shall be made by Bankline to Producer on or before the 20th day of the calendar month next succeeding that in which gasoline is produced. [68]

5. The Producer shall have at all reasonable times during business hours, the right to inspect the records and accounts of the Bankline relating to the production of gasoline from said plant or plants. Bankline shall keep accurate records showing the amount of gas taken from the Producer's property, the gasoline content thereof as indicated by the tests hereinafter provided for, and full records of the amount of gas handled in said plant or plants, the quantity of gasoline produced and sold, and to whom sold, and the prices received therefor, the amount of gas consumed for fuel, and the amount of dry gas sold (if any be sold). Bankline shall have the right to use such gas for fuel out of the gas furnished by Producer as it may require in the operation of said plant or plants, provided, however, that such amount shall be taken in the proportion that the wet gas taken by the Bankline under this contract bears to the total amount of wet gas taken by it; and provided further, that the total amount taken by Bankline for fuel and allowed for wastage shall not exceed twenty-five per centum (25%) of the volume of wet gas received from the Producer.

6. Bankline shall be entitled to refine, at and by means of said plant or plants, such quantities of gas as it may desire to take from other persons than Producer. Bankline shall meter separately the

(Testimony of Lloyd Aubert.)

gas received from Producer and from other producers whose gas is so taken, and at least once a month shall test separately, according to a recognized method for testing gas, samples of gas received from Producer and from such other producers. The amount of gasoline extracted from gas delivered by Producer shall be determined as a proportion of the total gasoline extracted at said plant, computed from said meter readings and said tests. The Producer shall be entitled to require Bankline to test meters at intervals of not less than one month, on reasonable notice.

7. Bankline may elect not to receive any gas from Producer containing gasoline in lesser quantities than three-tenths (3/10) of a gallon per thousand cubic feet of gas; nor shall it be required to take gas at a pressure of less than thirty pounds per square inch.

8. Bankline agrees to use its best efforts to sell the dry gas remaining after gasoline content has been extracted, and in event of sale thereof it shall account to Producer, on the 20th day of the next calendar month following that in which sale occurs, on the basis, as to quantity, of at least seventy-five per cent. (75%) of the volume of wet gas delivered to it by Producer. In the event Producer elects to have dry gas returned to it, all expense of redelivery shall be borne by it, and it shall notify Bankline at least six months in advance of its election to take dry gas. For the purpose of allowing for loss and fuel used in Bankline's plant and lines there shall

(Testimony of Lloyd Aubert.)

be [69] no obligation on the part of Bankline to deliver dry gas to Producer in excess of seventy-five per cent (75%) of the volume of wet gas received by Bankline from Producer. In the event that the Producer does not elect to take such dry gas to which it is entitled at the Bankline plant, and such gas be not sold, then Bankline shall be under no obligations whatsoever to Producer as to such dry gas. ~~Any contracts for the sale of dry gas, extending over a period of more than ..... months, shall be subject to the approval of the Producer.~~

9. The property affected by this agreement is located in Los Angeles, County, California, and particularly described as follows:

> Lots Seven (7), Eight (8) and Nine (9) of Block "G", of Signal Hill, as per map thereof recorded in the office of the County Recorder of Los Angeles County, Book 9, pages 2 and 3 of Maps, in the Records of said County.

10. The performance by either party of his or its obligations hereunder shall be excused so long as and to the extent that such performance is prevented by strikes, lockouts, delays of transportation companies, inability to obtain necessary labor or material in the open market, or other causes beyond the reasonable control of such party.

11. In the event of any dispute as to any matter arising out of this agreement, such dispute shall be submitted to arbitration. Each of the parties hereto shall select one arbitrator and the two so selected shall select a third, and a decision by any two of

(Testimony of Lloyd Aubert.)

such arbitrators shall be binding and conclusive upon the parties hereto.

12. In case of default by either party in the performance of his or its obligations hereunder, and the continuance of such default for thirty (30) days after written notice thereof, specifying the particulars of the default, the party not in default shall be entitled to terminate this agreement, and all rights and obligations hereunder shall thereupon cease and determine except as to the payment to the Producer of any money which may be due to it from the Bankline.

13. All notices from the Producer to the Bankline hereunder shall be sent by United States mail, postage prepaid, addressed to the Bankline at 310 Sansome Street, San Francisco, California. All notices from the Bankline to the Producer shall be likewise sent by United States mail, postage prepaid, addressed to the Producer at A. G. Bartlett Building, Los Angeles, California. [70]

14. In the event that the quantity of gas produced from this property, together with production from other properties with the owners of which Bankline has contracts for the purchase of gas, exceed the capacity of the Bankline plant, or of the available capacity of such other plant or plants as may treat gas supplied by Bankline, then shall the Bankline be required to take a pro rata only of the gas produced from this property so that with a like pro rata from other parties with whom the Bankline

(Testimony of Lloyd Aubert.)

has contracts, the capacity of the plant will not be exceeded; provided, however, that the producer may retain for its own use, free from any further claim of the Bankline, any surplus of gas supplied under this contract and any other of its contemporaneous contracts with Bankline, and for a consecutive period of thirty days at any time during the life of this contract not accepted and used by Bankline.

15. United agrees to indemnify and hold harmless the Bankline against all claims and demands of the lessors, holders of royalty interest, and/or F. N. Rumbley and/or their heirs or assigns, arising out of any act or omission of the Bankline under this agreement.

This agreement shall be binding upon and inure to the benefit of the heirs, successors and assigns of the respective parties hereto.

Executed in duplicate the day and year first hereinabove written.

THE UNITED OIL COMPANY

(Seal)
(UOCo)

By (s) C. F. WHITTIER
President

By (s) J. G. WALLACE
Secretary

BANKLINE OIL COMPANY

By (s) A. L. WEIL
Vice Pres.

By (s) R. C. PETERSON
Secretary

(Testimony of Lloyd Aubert.)

October 25th, 1923.

IN CONSIDERATION of the payment to it of the sum of Ten Dollars ($10.00) lawful money of the United States, the receipt of which is hereby acknowledged, the SIGNAL HILL GASOLINE COMPANY, a California corporation, does hereby cancel and surrender all rights and privileges; [71]

(a) Under that certain agreement dated May 23, 1922, between UNITED OIL COMPANY and SIGNAL HILL GASOLINE COMPANY; and

(b) Any and all rights which it may possess by virtue of any other contracts or agreements with UNITED OIL COMPANY relating to gas produced from any of the properties of the UNITED OIL COMPANY in the Signal Hill District;

Which interfere or may in the future interfere or be in conflict with any of the provisions of the foregoing contract between UNITED OIL COMPANY and BANKLINE OIL COMPANY, to which last mentioned contract this joinder is a part;

And United Oil Company hereby releases Signal Hill Gasoline Company from all obligations in conflict herewith.

SIGNAL HILL GASOLINE COMPANY

(Seal) By (s) R. V. KERTON
Pres.

By (s) J. G. WALLACE
Secy.

UNITED OIL COMPANY

(Seal) By (s) C. F. WHITTIER
Pres.

By (s) J. G. WALLACE
Secy.

(Testimony of Lloyd Aubert.)

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT NO. 3

a contract between Superior Oil Company and Bankline Oil Company, dated May 25, 1925, reading as follows:

THIS AGREEMENT, made and entered into this 25th day of May, 1925, by and between THE SUPERIOR OIL COMPANY, a corporation, duly organized and existing under and by virtue of the laws of the State of California, hereinafter designated as "Producer", and BANKLINE OIL COMPANY, California corporation, hereinafter designated as "Bankline",

WITNESSETH:

THAT WHEREAS, the Producer is the lessee of the hereinafter described premises, under an oil and gas lease from ROBT. H. BRITTON, MATTIE E. BRITTON, et al, as lessor, dated Mar. 28, 1922, and recorded in Book 1134 of ....., at page 238 thereof, records of Los Angeles County, California, and, [72]

WHEREAS, Bankline has erected a plant in the Signal Hill District, in said County of Los Angeles, capable of handling and treating gas for the extraction of gasoline therefrom; and,

WHEREAS, the Bankline, in order to augment its supply of gas for said plant, desires to purchase and receive from said Producer all of the natural

(Testimony of Lloyd Aubert.)

gas (except such gas as may be required in the development and operation of the property), which may be produced from the property hereinafter described, for the purpose of manufacturing and extracting gasoline therefrom;

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and other good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereto covenant and agree with each other as follows, to-wit:

1. The Producer hereby agrees to furnish and deliver to the Bankline, for the purpose of manufacturing and extracting gasoline therefrom, all of the gas produced on the lease (except such gas as may be required in the development and operation of the property, which it is understood may be retained by Producer if he so desires) for and during the entire period of time that gas shall be produced therefrom, the said Bankline being given the exclusive right to treat all gas produced as aforesaid.

2. The Producer shall deliver the gas at an approved gas-trap, to be installed and maintained by the Producer at a central point on the premises hereinafter described, and Bankline agrees to carry such vacuum or pressure at this point as Producer shall from time to time deem advisable. Bankline shall furnish, install and maintain necessary pipe connections from said gas trap to said plant, and necessary meter or meters for the measurement of gas delivered from said premises. The Producer

(Testimony of Lloyd Aubert.)

shall furnish right of way for said pipe lines and connections on the premises hereinafter described, and the Bankline elsewhere. The Bankline shall be entitled to remove on termination of this agreement all pipe connections, meters and other equipment installed by it.

3. In full consideration of the rights herein granted the Bankline agrees to pay to Producer one-third (33-1/3%) of the gross proceeds received by it from the sales of gasoline manufactured or extracted from said gas. Bankline shall have the right to sell royalty gasoline with [73] its own share of the product and continue to do so if no election be made by the Producer to take his royalty gasoline in kind. Producer shall have the right to take his royalty gasoline in kind, provided he shall in such event serve Bankline with thirty days' advance notice in writing of such intention, and such election to take royalty gasoline in kind shall be exercised not oftener than once in every six calendar months.

In the event royalty gasoline be paid in kind, producer shall be entitled to thirty days free storage of his royalty gasoline in tanks provided by Bankline, provided that such storage shall be at Producer's sole risk as to loss by evaporation, fire, or any other cause.

4. Royalty payments shall be made by Bankline to Producer on or before the 20th day of the calendar month next succeeding that in which gasoline is produced.

(Testimony of Lloyd Aubert.)

5. The Producer shall have at all reasonable times during business hours, the right to inspect the records and accounts of the Bankline relating to the production of gasoline from said plant or plants. Bankline shall keep accurate records and furnish the Producer with a statement thereof, showing the amount of gas taken from the Producer's property, the gasoline content thereof as indicated by the tests hereinafter provided for, and full records of the amount of gas handled in said plant or plants, the quantity of gasoline produced and sold, and the prices received therefor, the amount of gas consumed for fuel, and the amount of dry gas sold (if any be sold). Bankline shall have the right to use such gas for fuel out of the gas furnished by Producer as it may require in the operation of said plant or plants in which Producer's gas is utilized. The amount of gas wasted or used for fuel shall be apportioned against the various producers on the basis of the quantities delivered to the plant.

6. Bankline shall be entitled to refine, at and by means of said plant or plants, such quantities of gas as it may desire to take from other persons than Producer. Bankline shall meter separately the gas received from Producer and from other producers whose gas is so taken, and at least once a month shall test separately, according to a recognized method for testing gas, samples of gas received from Producer and from such other producers. The amount of gasoline extracted from gas delivered by

(Testimony of Lloyd Aubert.)

Producer shall be determined as a proportion of hte total gasoline extracted at said plant, computed from said meter readings and said tests. The producer shall be entitled to require Bankline to test meters at intervals of not less than one month on reasonable notice. [74]

7. Bankline agrees to maintain sufficient vacuum on its lines at all times to handle all gas produced on the lease or leases, but may elect not to receive any gas from Producer which does not contain gasoline in commercial quantities. Any gas tendered to Bankline under this agreement and rejected by them may be disposed of elsewhere by Producer.

8. Bankline agrees to use its best efforts to sell the dry gas remaining after gasoline content has been extracted, and in event of sale thereof it shall account to Producer, on the 20th day of the next calendar month following that in which sale occurs, on the basis, as to quantity, of at least seventy-five per cent. (75%) of the volume of wet gas delivered to it by Producer. Bankline agrees to pay to Producer for all dry gas sold the entire gross proceeds of such sale, less the actual cost of compressing and marketing the same, in any event not to exceed four cents (4¢) per M. cubic feet. In the event Producer elects to have dry gas returned to him, the same shall be returned at a pressure of at least 25 pounds per square inch at the plant, but all expense of redelivery shall be borne by him. For the purpose of allowing for loss and fuel used in Bankline's plant and lines there shall be no obligation on the part of

(Testimony of Lloyd Aubert.)

Bankline to deliver dry gas to Producer in excess of seventy-five per cent. (75%) of the volume of wet gas received by Bankline from Producer. In the event that the Producer does not elect to take such dry gas to which it is entitled at the Bankline plant, and such gas be not sold, then Bankline shall be under no obligations whatsoever to Producer as to such dry gas.

9. The property affected by this agreement is located in Los Angeles County, California, and particularly described as follows:

Lots Eighteen and Nineteen Block forty-eight (48) East one-half (E½) of Lot Eighteen (18) and West one-half (W½) of Lot Seventeen (17) of Block Forty-three (43), Peck & Anderson Tract, Los Angeles County, as per map recorded in Book 4, Page 11, containing 3 acres.

Lots one (1), two (2), three (3), four (4) and five (5), Block Forty-three (43); P. & A. Tract, containing 5 acres.

East one-half (E½) Lot seventeen (17) and Lot Sixteen (16), Block Forty-three (43) P. & A. Tract, containing 1½ acres. [75]

10. The performance by either pary of his or its obligations hereunder shall be excused so long as and to the extent that such performance is prevented by strikes, lockouts, delays of transportation companies, inability to obtain necessary labor or material in the open market, or other causes beyond the reasonable control of such party.

(Testimony of Lloyd Aubert.)

11. In the event of any dispute as to any matter arising out of this agreement, such dispute shall be submitted to arbitration. Each of the parties hereto shall select one arbitrator and the two so selected shall select a third, and a decision by any two of such arbitrators shall be binding and conclusive upon the parties hereto.

12. In case of default by either party in the performance of his or its obligations hereunder, and the continuance of such default for thirty (30) days after written notice thereof, specifying the particulars of the default, the party not in default shall be entitled to terminate this agreement, and all rights and obligations hereunder shall thereupon cease and determine except as to the payment to the Producer of any money which may be due to it from the Bankline.

13. All notices from the Producer to the Bankline hereunder shall be sent by United States mail, postage prepaid, addressed to the Bankline at 310 Sansome Street, San Francisco, California. All notices from the Bankline to the Producer shall be likewise sent by United States mail, postage prepaid, addressed to the Producer at 1203 A. G. Bartlett Building, Los Angeles, California.

This agreement shall be binding upon and inure to the benefit of the heirs, successors and assigns of the respective parties hereto.

(Testimony of Lloyd Aubert.)

Executed in duplicate the day and year first hereinabove written.

THE SUPERIOR OIL COMPANY

(Seal) By (s) W. M. Keck

Pres.

And F. D. JONES

Asst. Secy.

BANKLINE OIL COMPANY

By

And

We, the undersigned, lessors in that certain lease above mentioned (or present owners of the property above de- [76] scribed or having an interest in the royalties or production therefrom) do hereby join in the foregoing contract in so far as our royalty gas, if any, is concerned; all payments to us to be made to ..... Such payments shall relieve Bankline Oil Company from seeing to the proper distribution thereof.

Dated ....., 1925.

.....

.....

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT NO. 4

a contract between United Oil Company and Bankline Oil Company, dated October 25, 1923. Said contract was in the same words and figures as peti-

(Testimony of Lloyd Aubert.)

tioner's Exhibit No. 2, except that the said contract referred to the so-called Denni Lease No. 2, and the property from which said gas was to be taken was specifically described and different from the property described in Exhibit No. 2.

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT NO. 5

a contract between United Oil Company and Bankline Oil Company, dated October 25, 1923. Said contract was in the same words and figures as petitioner's Exhibit No. 2, except that the said contract referred to the so-called Malcolm Davis Lease, and the property from which said gas was to be taken was specifically described and different from the property described in Exhibit No. 2. [77]

There was thereupon introduced and received in evidence as petitioner's

EXHIBIT NO. 6

a contract between General Petroleum Corporation and Bankline Oil Company, dated June 9, 1922, reading as follows:

THIS AGREEMENT, made and entered into this 9th day of June, 1922, by and between the GENERAL PETROLEUM CORPORATION, a corporation organized and existing under and by virtue of the laws of the State of California, hereinafter called the first party, and the BANKLINE

(Testimony of Lloyd Aubert.)

OIL COMPANY, likewise a California corporation, hereinafter called the second party,

WITNESSETH:

That, whereas, the first party is the holder and owner of certain leases in what is known as the Signal Hill District, and,

Whereas, first party desires to sell and second party desires to buy upon a royalty basis the gasoline which may be extracted from the gas produced by the first party from said lands in the Signal Hill District;

Now, therefore, in consideration of the sum of Ten ($10.00) Dollars each to the other in hand paid, receipt of which is hereby acknowledged, and the faithful performance of the covenants hereinafter expressed, it is agreed as follows:

First: The party of the second part will erect, equip, maintain and operate upon what is known as the Jasper Lease, being the east six hundred and sixty (660') feet of the north six hundred and thirty (630') feet of Block sixty-four (64), American Colony Tract, as per map recorded in Book nineteen (19) Page eight (8), Miscellaneous Records of Los Angeles County, a plant or plants for the recovery of gasoline from casing-head gas, and will lay, maintain, remove and replace any and all pipe necessary to the operation of said plant or plants. However, the erection, operation and maintenance of said plant or plants shall in no manner interfere

(Testimony of Lloyd Aubert.)

with the proper and efficient working or development of said lands above described, nor any part thereof, by the said first party, for the production of oil therefrom.

Second: The said party of the second part agrees to immediately commence preparation for the erection, maintenance and operation of an absorption plant for extracting the gasoline from [78] the natural or casing-head gas produced by said party of the first part in said Signal Hill District, and to complete the same and have it in operation within ninety (90) days from the date of the execution of this contract. Such plant or plants shall be of sufficient size and capacity to treat all the gas of the kind and quality hereinafter described that may be produced by said party of the first part from said premises, and the said party of the second part agrees that such plant or plants shall be of such efficiency as to remove approximately ninety (90) per cent of all of the recoverable gasoline content which such natural gas carries; and further agrees to provide suitable and efficient apparatus for protection against fire and to use only skilled and efficient help to keep the premises in and about the plant in a neat, clean and workmanlike manner; and further agrees to keep the plant in full operation continuously subject only to fires, strikes, acts of God, public enemies and other causes beyond the control of the second party, so long as not less than one million feet of gas per day shall be delivered by the first party to the second party.

(Testimony of Lloyd Aubert.)

Third: The second party further agrees to submit for approval to the first party plans and drawings of said plant previous to the installation thereof.

Fourth: It is understood and agreed that the first party is operating the wells in the Signal Hill District primarily for oil production and may at any time discontinue production on any or all thereof or redrill the same or make any changes in the operation of such wells or any of them, as in its judgment it may deem desirable, regardless of the effect such change may have on the amount or quality of the gas produced; and it is further understood that the first party has not made and does not make any representations whatsoever as to the quantity, quality or pressure of gas.

Fifth: The first party hereby agrees to deliver to the second party at the traps or casing-heads of the wells in said Signal Hill District during the life of this agreement as hereinafter set forth, all gas which is now or which may be hereafter produced by the first party from any or all wells located in said Signal Hill District, and the said second party shall have the right to apply such vacuum if any as the first party shall hereafter indicate, and the vacuum to be applied to such wells may be changed from time to time as conditions in such wells warrant, but such change can only be made upon the sanction and consent in writing of said first party.

Sixth: The second party agrees to pay to the first party for said gas a royalty based upon the

(Testimony of Lloyd Aubert.)

average daily production of gasoline for any calendar month at the rate of thirty-three and one-third (33-1/3%) per cent of the gross amount of the gasoline [79] extracted from the aforesaid gas.

Seventh: The first party hereby reserves the right to take the royalty either in money or gasoline, and further reserves the right to approve any contract the second party may make for the sale of the royalty gasoline in the event the first party elects to accept its royalty in money. An option once exercised to take either in money or in kind shall not be changed for at least six months. In the absence of any written notice, it shall be deemed that the party of the first part elects to take its royalty in money.

Eighth: It is understood and agreed that in the event the first party elects to accept is royalty in money, it is to receive payment on the tenth day of the month for the production of the previous calendar month, and in the event the first party elects to accept its royalty in gasoline the same shall be stored free of charge by the second party for a period of ten days from and after the first day of the month following that in which the gasoline is produced.

Ninth: In this connection it is distinctly understood and agreed that the party of the second part shall not be obligated to make such installation or to treat gas containing four-tenths (4/10) of one gallon of gasoline per thousand cubic feet or less, unless the party of the second part may so elect, and in the event the said party of the second part shall refuse to treat gas containing four-tenths (4/10)

(Testimony of Lloyd Aubert.)

or less of one gallon of gasoline per thousand cubic feet, the party of the first part may sell and dispose of such gas in any manner it may so desire.

Tenth: The second party agrees to deliver to the party of the first part after treatment a minimum of seventy (70%) per cent of the gas collected from the wells and put into the plant for treatment, and further agrees to deliver such gas at a pressure sufficient to enable the first party to deliver said gas to a compressor plant to be erected adjacent to the plant of the second party, such pressure to be not less than ten pounds to the square inch, and in no event shall such pressure exceed one hundred pounds to the square inch unless at the consent of the first party.

Eleventh: It is further agreed that the second party shall have the privilege and option of treating gas in said plant other than that received from the first party, but it is distinctly understood and agreed that in this event orifice meters shall be installed on incoming and outgoing gas to and from the different owners, in order that at all times first party will secure and receive proper credit for the gas produced by it from its wells and received by the second party.

Twelfth: It is further agreed that the first party shall have free access to the plant at all times during business hours and [80] that the books of the second party insofar as they refer to the affairs of the first party shall be open to its inspection.

(Testimony of Lloyd Aubert.)

Thirteenth: The second party agrees to erect such storage tanks upon the property as may be necessary to store the gasoline produced in said plant, and such tanks shall be insulated and of such type and equipment as to prevent an undue amount of evaporation.

Fourteenth: It is further agreed that the first party shall furnish the second party the pro rata quantity of fuel used by the second party in the operation of said plant, and such pro rata quantity of fuel shall be based upon the total volume of gas handled in said plant.

Fifteenth: The second party further agrees to protect and hold harmless the first party on account of any litigation or damages that may arise by reason of method of treatment applied by said second party to said gas, or the design of the plant erected upon said premises, and also agrees to hold first party harmless on account of any accident or injury to any person or persons or any surrounding property that may arise out of the erection or operation or maintenance of said plant, and to pay all County, State and Government taxes that may be levied against said plant or its operation, not including taxes which the first party is required to pay on account of the royalty it receives from the extraction of such gasoline.

Sixteenth: The first party hereby guarantees that it is the owner of and is lawfully entitled to deliver to said second party such gas as is now produced or may hereafter be produced in the said Signal Hill

(Testimony of Lloyd Aubert.)

District, and will hold harmless said second party on account of any litigation that may hereafter arise between the parties hereto and any third party on account of the failure or pretended failure of the first party to deliver such gas to any other person or corporation than the second party hereto.

Seventeenth: In the event said second party shall treat in said plant gas other than that produced by the said party of the first part from said premises herein described, the quantity of gasoline contained in the respective gases so treated in said plant shall be determined by weekly tests of separate gases delivered and treated at said plant.

Eighteenth: This agreement shall continue in force and effect so long as the party of the first part shall have available gas in the said Signal Hill District.

Nineteenth: It is further distinctly understood and agreed that in determining any question or dispute which may arise in the [81] execution of this contract that the same shall be determined by a Board of Arbitrators to be composed of one member appointed by the first party and one member appointed by the second party, and those two persons to appoint a disinterested third person, and the decision of the majority of the Board of Arbitrators shall prevail.

In the event of breach of any of the terms of this contract by the second party, and a continuance of said breach for thirty days after written notice by

(Testimony of Lloyd Aubert.)

the first party to the second party to perform said contract, then at the option of the first party, this contract shall forthwith become null and void and the rights of the second party to receive any further gas from the lands hereinabove described shall cease and determine.

IN WITNESS WHEREOF, the parties hereto have caused this contract to be executed in triplicate by their proper officials, who were thereunto duly authorized.

GENERAL PETROLEUM CORPORATION

(Seal) By (s) R. E. MAYNARD
Vice President

By (s) D. W. WOODS,
Asst. Secretary.

BANKLINE OIL COMPANY

(Seal) By (s) A. L. WEIL
Vice President

By (s) R. C. PETERSON
Sec'y.

Cross-Examination.

I have been General Manager of Bankline Oil Company since 1927. I am familiar with the operation of a company treating gasoline under casinghead gas contracts. I am familiar with the general [82] types of contract used in the field in 1927, 1928 and 1929.

I do not know whether there were two types of contracts in use at that time. I cannot interpret the

(Testimony of Lloyd Aubert.)

contracts which have been submitted in evidence. They speak for themselves. I believe there is one type of contract under which the Bankline Oil Company operates.

(Witness was thereupon referred to preamble of Exhibit 1 and Exhibit 2.)

The two statements mean exactly the same to me.

SCOTT H. DUNHAM,

being first duly sworn, testified on behalf of petitioner as follows:

I reside in Berkeley, California. I am a certified public accountant in charge of tax work for the firm of Haskins and Sells, and have been in that business for five years. As a part of my professional duties I have examined the books of Bankline Oil Company for the years 1927, 1928 and 1930. I have also had a great deal of work on these books done by a crew of ten or twelve different men who were working under my supervision. They compiled information setting forth the gross income derived under each casinghead gas contract, the royalties paid, various statistics relating to the volume of gas coming from each, theoretical content of gasoline, the actual gasoline re- [83] covered, the dry gas recovered under each lease and sold, the royalties paid on the dry gas, and the gross revenue after payment of all royalties. That has been collected in the statement.

(Testimony of Scott H. Dunham.)

Counsel for respondent having objected to the materiality of said statement counsel for petitioner stated:

"Practically all of these contracts provide for a 33-1/3 per cent royalty. We will show, for example, in the several years that the royalty was 40 or 45 per cent. That is the market value of the gas at the well. We paid a 33-1/3 per cent royalty. The case was worth 40 per cent., we will assume, for a given year. The difference between 33-1/3 per cent. and 40 per cent. we will claim under this Board of Tax Appeals decision is the amount on which the depletion shall be taken, and we have got to show what the numbers involved were. We are not asking counsel to concede or admit in any way by the admission of this testimony that we did have a depletable interest in there or that that is the proper method of computing the value of the depletable interest."

Whereupon counsel for respondent said:

"With counsel's statement, there is no objection."

The said statement was then introduced in evidence as petitioner's Exhibit No. 8, as follows: [84]

(Testimony of Scott H. Dunham.)

BANKLINE OIL COMPANY

SUMMARY REFLECTING GROSS INCOME DERIVED FROM ABSORPTION PLANT OPERATIONS, AMOUNTS RECEIVED ON SALES OF ALL PRODUCTS DERIVED FROM THE TAXPAY
IN NATURAL GAS RESERVES ACQUIRED UNDER THE PROVISIONS OF CASINGHEAD GAS CONTRACTS, ROYALTIES PAID THEREON, ETC., FOR THE CALENDAR YEAR

	GASOLINE						DRY GAS								Gross income from gasoline, dry gas, etc.
	Wet gas delivered to plant M cu. ft.	Theoretical gasoline content Gallons	Gasoline recovered Gallons	Less royalties Gallons	Value of gasoline recovered Amount	Less royalties Amount	Plant fuel shrinkage and line loss M cu. ft.	Dry gas available for delivery to lessor or for sale M cu. ft.	Dry gas returned to lessor M cu. ft.	Dry gas available for sale M cu. ft.	Gas blown to air M cu. ft.	Gas sales M cu. ft.	Gas sales Amount	Less royalties Amount	
Bankline account Superior							26,949				146				
General Petroleum Corporation	1,678,337	5,563,455	4,693,962	1,564,656	$468,221.31	$156,073.97	507,163	1,171,174	606,125	565,049	321	564,728	$53,615.23	$26,807.63	$521,836.54
Superior Oil Co.	523,798	1,790,603	1,508,686	502,893	150,191.22	50,063.53	130,950	392,848	154,942	237,906*					150,191.22
Bankline Oil Company	45,940	100,619	80,594	26,866	8,082.15	2,694.17	14,122	31,818	1,129	30,689	7	30,682	3,068.20	1,534.10	11,150.35
Sterling Absorption Plant	1,184		3,115	2,336	404.95	303.68	354	830	545	285		285	27.58		432.59
Total	2,249,259	7,454,677	6,286,357	2,096,751	$626,899.63	$209,135.35	679,538	1,596,670	762,741	833,929	474	595,695	$56,711.01	$28,341.73	$683,610.64

*Indicates M cu. ft. delivered to Midway for Superior.

SUMMARY REFLECTING TOTAL INCOME RECEIVED AND ROYALTIES PAID IN CONNECTION WITH ABSORPTION PLANT OPERATIONS

	Gross income	Less royalties	Income after deducting royalties
Recorded income attributable to and royalties paid under all casinghead gas contracts	$683,610.64	$237,477.08	$446,133.56
Dry gas delivered on order of General Petroleum Corporation	26,885.69	26,807.63	78.06
Total	$656,724.95	$210,669.45	$446,055.50
Wet gas sales—Unlocated	481.63	)	
Royalties—Sterling Absorption Plant—Unlocated	13.79	393.68)	101.74
Remainder	$656,229.53	$210,275.77	$445,953.76
Revenue from gasoline derived from absorber oil	13,672.70		13,672.70
Revenue from dry gas sales not distributed to lessors	16,105.81		16,105.81
Charges to Delano Land Co. for difference between value of dry gas and wet gas supplied	983.43		983.43
Cancellation of charges for transportation costs—1926	570.87		570.87
Excess plant fuel from Superior leases	1,729.70		1,729.70
Total	$685,832.64	$210,275.77	$475,556.87

VED FROM THE TAXPAYER'S INTEREST
R THE CALENDAR YEAR 1927

	Less royalties Amount	Gross income from gasoline, dry gas, etc.	Less royalties paid	Income after deducting royalties
23	$26,807.63	$521,836.54	$182,881.60	$338,954.94
		150,191.22	50,063.53	100,127.69
20	1,534.10	11,150.35	4,228.27	6,922.08
58		432.53	303.68	128.85
31	$28,341.73	$683,610.64	$237,477.08	$446,133.56

ERATIONS

Income after deducting royalties
$446,133.56
78.06
$446,055.50
101.74
$445,953.76
13,672.70
16,105.81
983.43
570.87
1,729.70
$475,556.87

(Testimony of Scott H. Dunham.)

BANKLINE OIL COMPANY

SUMMARY REFLECTING GROSS INCOME DERIVED FROM ABSORPTION PLANT OPERATIONS, AMOUNTS RECEIVED ON SALES OF ALL PRODUCTS DERIVED FROM THE TAX
IN NATURAL GAS RESERVES ACQUIRED UNDER THE PROVISIONS OF CASINGHEAD GAS CONTRACTS, ROYALTIES PAID THEREON, ETC., FOR THE CALENDAR Y

	GASOLINE						DRY GAS							
	Wet gas delivered to plant M cu. ft.	Theoretical gasoline content Gallons	Gasoline recovered Gallons	Less royalties Gallons	Value of gasoline recovered Amount	Less royalties Amount	Plant fuel shrinkage and line loss M cu. ft.	Dry gas available for delivery to lessor or for sale M cu. ft.	Dry gas returned to lessor M cu. ft.	Dry gas available for sale M cu. ft.	Gas blown to air M cu. ft.	Gas sales M cu. ft.	Gas sales Amount	Less royalties Amount
Bankline account Superior							88,915							
General Petroleum Corporation	4,273,185	11,050,487	6,935,409	2,311,803	$590,513.23	$196,837.72	513,742	3,759,443	721,649	3,037,794	1,467,876	1,569,918	$156,991.80	$78,495.90
Superior Oil Co.	847,155	3,046,491	1,925,074	641,687	164,112.08	54,703.68	211,783	635,372	150,026	485,346	85,751	399,595*		
Bankline Oil Company	113,884	273,834	175,773	58,593	15,008.24	5,002.93	18,365	95,519		95,519		95,519	9,551.90	4,665.20
Total	5,234,224	14,370,812	9,036,256	3,012,083	$769,633.55	$256,544.33	654,975	4,490,334	871,675	3,618,659	1,553,627	2,065,032	$166,543.70	$83,161.10

*Delivered to Midway Gas Co. for Superior.

SUMMARY REFLECTING TOTAL INCOME RECEIVED AND ROYALTIES PAID IN CONNECTION WITH ABSORPTION PLANT OPERATIONS

	Gross income	Less royalties	Income after deducting royalties
Recorded income attributable to and royalties paid under all casinghead gas contracts	$936,177.25	$339,705.43	$596,471.82
Dry gas delivered on order of General Petroleum Corporation	78,495.90	78,495.90	
Total	$857,681.35	$261,209.53	$596,471.82
Revenue from gasoline derived from absorber oil	13,535.65		13,535.65
Revenue from dry gas sales not distributed to lessors	13,487.60		13,487.60
Plant fuel and shrinkage adjustment—Superior leases	8,891.50		8,891.50
Total	$893,596.10	$261,209.53	$632,386.57
Correction of 1927 charges to General Petroleum Corporation	12.05		12.05
Remainder	$893,584.05	$261,209.53	$632,374.52

RIVED FROM THE TAXPAYER'S INTEREST
FOR THE CALENDAR YEAR 1928

Gas sales Amount	Less royalties Amount	Gross income from gasoline, dry gas, etc.	Less royalties paid	Income after deducting royalties
$156,991.80	$78,495.90	$747,505.03	$275,333.62	$472,171.41
		164,112.08	54,703.68	109,408.40
9,551.90	4,665.20	24,560.14	9,668.13	14,892.01
$166,543.70	$83,161.10	$936,177.25	$339,705.43	$596,471.82

OPERATIONS

Income after deducting royalties
$596,471.82
$596,471.82
13,535.65
13,487.60
8,891.50
$632,386.57
12.05
$632,374.52

BANKLINE OIL COMPANY

SUMMARY REFLECTING GROSS INCOME DERIVED FROM ABSORPTION PLANT OPERATIONS, AMOUNTS RECEIVED ON SALES OF ALL PRODUCTS DERIVED FROM THE TAXP
IN NATURAL GAS RESERVES ACQUIRED UNDER THE PROVISIONS OF CASINGHEAD GAS CONTRACTS, ROYALTIES PAID THEREON, ETC., FOR THE CALENDAR YE

	GASOLINE						DRY GAS								Gro
	Wet gas delivered to plant M cu. ft.	Theoretical gasoline content Gallons	Gasoline recovered Gallons	Less royalties Gallons	Value of gasoline delivered Amount	Less royalties Amount	Plant fuel Shrinkage and line loss M cu. ft.	Dry gas available for delivery to lessor M cu. ft.	Dry gas returned to lessor M cu. ft.	Dry gas available for sale M cu. ft.	Gas blown to air M cu. ft.	Gas sales M cu. ft.	Gas sales Amount	Less royalties	gas
Bankline—Adjustment account Superior							14,559								
Bankline Oil Company	52,798	142,536	113,815	37,938	$ 8,530.74	$ 2,843.59	11,331	41,467	2,201	39,266		39,266	$ 3,926.60	$ 1,963.30	$ 1
General Petroleum Corporation	2,052,999	5,173,337	4,125,300	1,375,099	309,220.79	103,132.40	438,038	1,614,961	997,818	617,143		617,143	61,714.30	30,857.15	37
Richfield Oil Company	4,101	37,473	29,958	9,986	2,245.86	748,65	902	3,199		3,199		3,199	319.90	159.95	
Superior Oil Co.	448,362	1,179,288	941,852	313,951	70,599.09	23,533.04	91,526	336,836	335,927	909		909			7
Total	2,558,260	6,532,634	5,210,925	1,736,974	$390,596.48	$130,257.68	527,238	1,996,463	1,335,946	660,517		660,517	$65,960.80	$32,980.40	$45

SUMMARY REFLECTING TOTAL INCOME RECEIVED AND ROYALTIES PAID IN CONNECTION WITH ABSORPTION PLANT OPERATIONS

	Gross income	Less royalties	Income after deducting royalties
Recorded income attributable to and royalties paid under all casinghead gas contracts	$456,557.28	$163,238.08	$293,319.20
Dry gas delivered on order of General Petroleum Corporation	30,857.15	30,857.15	
Total	$425,700.13	$132,380.93	$293,319.20
Revenue from gasoline derived from absorber oil	5,440.29		5,440.29
Revenue from dry gas sales not distributed to lessors	1,258.50		1,258.50
Total	$432,398.92	$132,380.93	$300,017.99

ERIVED FROM THE TAXPAYER'S INTEREST
, FOR THE CALENDAR YEAR 1930

Gas sales Amount	Less royalties	Gross income from gasoline, dry gas, etc.	Less royalties paid	Income after deducting royalties
$ 3,926.60	$ 1,963.30	$ 12,457.34	$ 4,806.89	$ 7,650.45
61,714.30	30,857.15	370,935.09	133,989.55	236,945.54
319.90	159.95	2,565.76	908.60	1,657.16
		70,599.09	23,533.04	47,066.05
$65,960.80	$32,980.40	$456,557.28	$163,238.08	$293,319.20

OPERATIONS

	Income after deducting royalties
3	$293,319.20
5	
3	$293,319.20
	5,440.29
	1,258.50
3	$300,017.99

J. LEE CROSS,

being first duly sworn, testified on behalf of petitioner as follows:

I reside in Los Angeles. I am in the business of making contracts for gasoline and leases with land owners. I have been in that business over twenty years, and between the years 1925 to 1932 I have been connected with Signal Oil and Gas Company, California Gasoline Company, Southwestern Gasoline Company, California Gasoline Corporation, California Petroleum Company, The Texas Company, The Signal Company and the Los Angeles Gasoline Company. My duties were to secure gas contracts for these companies. By that I mean contract for the gas produced with the oil at the well. A casinghead company is a gas treating company that lays lines to the producing wells. They take the natural gas at the mouth of the well, carry it through their own pipe lines to their own plant, and extract the gasoline therefrom. During the years in question no wet gas was ever sold at the mouth of the well for cash. The ordinary procedure of purchasing this gas is for the gasoline absorption company to pay a royalty on the gasoline extracted from the gas. During the years 1925 to 1932 I was familiar with the fair market value of casinghead gas at the wells in Signal Hill and Santa Fe Springs oil fields. The markets were practically the same. The amount of royalty paid varied from year to year. In 1922 the prevailing royalty at the well was 33%; in 1926 it was 42½% to 45%; in 1927 it was 45%; in 1928

(Testimony of J. Lee Cross.)

47½%; and in 1930, and since then, about 50%; in 1925 it was 42½%. [88]

Cross-Examination by Mr. Brabson.

We sometimes made gasoline contracts with land owners, but more often with the producer. I also made contracts with the oil lessees. They are the producers. We made some contracts with lessors direct. I was not acting as a real estate agent but as a contract man in these transactions.

The various oil companies I mentioned were practically one company. I have had the same job but have been transferred from company to company. I was on a salary all the time. I did not make any of the contracts in question in this suit.

I don't know whether natural gas is ever sold at the well, but I don't know of any that was ever sold for cash where there were casinghead plants. There is a great variance in the gasoline content of wet gas, which varies from field to field. I don't know that this is the real reason there is no posted price for wet gas. I think the reason is that the contracts are made with the operator prior to the time the wells come in.

It makes no difference whether the gas is rich or lean, whether you have a half gallon or four or five gallons. The royalty rate is just the same.

Ninety to ninety-five percent of the extraction contracts are made before the wells are brought in. The gasoline content varies from half a gallon to five or six gallons per 1000 cubic feet of gas. That means that from some gas the [89] absorption plant

(Testimony of J. Lee Cross.)

can extract half a gallon of gasoline, and from others four or five gallons.

Gas coming from an oil well is not salable to the consuming public as a general rule. The primary reason for casinghead contracts is to extract the gasoline and pay the operator a proportionate amount for the gasoline in the gas. I don't think the operator is primarily interested in getting his wet gas converted to dry gas so he can sell it. Generally speaking his gas is not salable as it comes out.

I would think that public utilities would accept wet gas because if it is wet then they can establish a gasoline plant to extract the gasoline. It is the gasoline in the gas that makes the gas of value. I think that some public utilities do that in Los Angeles, California. They get their gas from various operators, not from our company, as we have our own gasoline plant. I do not know anything about deliveries of gas from the gas companies to the consumers, as I am in the casinghead business. I know about the operation of a casinghead gas plant, and I made contracts similar to those involved in this case.

It is not a fact that there are two general types of contracts. The gasoline company acts the same under all contracts, and assumes all contracts are as one. While firms may have worded them differently, they are operated on exactly the same by all absorption plants. I have worked for pretty nearly half of the absorption plants. I make no distinction in a

(Testimony of J. Lee Cross.)

contract providing for the purchase and sale of gas, and one merely providing for the treatment of it; they are all processing contracts. [90]

The reason the contracts do not provide for a price per unit for the wet gas but a royalty is based upon custom. The varying content of gasoline in the gas is one of the factors why royalty basis is more acceptable than a flat purchase. Another factor is, the gas pressure at the well, whether the company can get it into the lines or has to use compressors.

Q. That would be the same whether it was on a royalty basis or whether it was on a unit basis, would it not?

A. Surely, but it is still a factor in the value of the gas.

Q. If that is the same factor in both cases, how does it make any difference?

A. I do not believe you are making yourself clear.

Q. Well, anyhow, wet gas is never sold on a basis of a unit price, is it?

A. Not to my knowledge.

Generally the contracts provide that after the extraction of the gasoline, the dry gas is returned to the producer.

I have no evidence except my bare statement that royalties paid on contracts vary from 33-1/3% in 1923 to 50% in 1930. I do not know what these contracts provide, and I am not familiar with contracts made by Bankline Oil Company since 1923.

(Testimony of J. Lee Cross.)

While I have not made any contracts for Bankline since 1923, I believe I know the royalties they paid. I have seen lots of contracts where they were attempting to get business in competition with ourselves and other companies, even though I have not seen any of the contracts here in question.

I am familiar with the general type of casinghead gas contracts entered into for extraction of gasoline in which the owner of the casinghead plant goes to an operator and says that he would treat his gas for so much royalty. Only the gas, and not the oil that comes out of the well, is the subject on which these contracts operate. [91]

T. L. TAGGART,

being first duly sworn, testified on behalf of petitioner as follows:

I reside in Los Angeles County, and am contract superintendent of the Standard Gasoline Company. I have had that job since 1926, when that company was formed. I was also in the natural gasoline business before that time.

The Standard Gasoline Company is the biggest casinghead gasoline company in the state. My duties with that company are to make gas processing contracts. The natural gas is sold on a royalty basis, and is not sold for cash.

I know the going rate of royalty on casinghead contracts between 1925 and 1932 in Santa Fe Springs

(Testimony of T. L. Taggart.)

and Signal Hill oil fields. It was the same in both places and varying from year to year. In 1925 the going rate was 35%; in 1926 41%; in 1927 it averaged about 43%; in 1928 it was 45%; in 1929 about the same; in 1930 about 47%; and since that time it has gradually increased to 50%.

Cross-Examination by Mr. Brabson.

I have never made any contracts with Bankline Oil Company and am not familiar with any of their contracts.

Witness then shown petitioner's Exhibit No. 1, dated October 9, 1928, and on examination states that he sees a clause in which Bankline agrees to pay the producer 33-1/3% of the gross [92] proceeds derived from the sale of gasoline extracted from wet gas taken from the property covered by the contract. Counsel for petitioner then admitted that was the only royalty.

Witness was handed petitioner's Exhibit No. 2, dated October 25, 1923, and stated that this provides for 33-1/3% royalty.

Witness was then handed petitioner's Exhibit No. 7 dated October 9, 1928, and stated that royalty is 33-1/3%.

I made gas processing contracts during 1927, 1928 and 1930 for the Standard Gasoline Company in the same field. I did not make any 33-1/3% contracts during those years. I cannot deny that there were not some contracts that were entered into on the 33-1/3% basis during those years. I just testified

(Testimony of T. L. Taggart.)

we did not make any at that rate. All the contracts made by Standard Gasoline Company passed through my office. I make no distinction between a gas treatment contract and a contract for purchase and sale.

JOHN McFARLAND,

being first duly sworn, testified on behalf of petitioner as follows:

I reside in Glendale, California. I am in the natural gas business in charge of the Contract Department of Gilmore Oil Company, Gilmore Dabney, and Gilmore Plant No. 1. I have been in that business since the beginning of 1924, and know the going rates of royalty paid on casinghead gasoline contracts in Santa [93] Fe Springs and Signal Hill fields for the years 1926 to 1930. They were the same in both fields, but varied from year to year. In 1925 the going rate was 37½%; in 1926 40%; in 1927 45%; in 1928 to 1932, inclusive, 50%; in 1933 52½%.

Petitioner thereupon rested.

F. K. BAXTER,

being first duly sworn, testified on behalf of respondent as follows:

I reside in Pasadena, and am engineer revenue agent with the Internal Revenue Bureau. I entered

(Testimony of F. K. Baxter.)

the employ of the Federal Government in 1922 as a valuation engineer, and I came to California in 1925. I became an engineer revenue agent, the duties being unchanged. I graduated from the Massachusetts Institute of Technology in 1901, taking a course in mining engineering and metallurgy, which also included oil and gas. I followed mining until about 1908 when I entered the employ of the Associated Oil Company in the Geological Department. After two years with them I went into private practice as a mining and petroleum engineer in California. I remained a consulting engineer for about two years, and in 1913 entered the employ of the Shell Company. I worked for seven years with them as an engineer in their Geological Department. My duties with those companies were mapping oil fields and obtaining information relative to oil wells and their conditions. I never had anything to do with a casinghead gasoline plant, although I submitted a design for one of the first ones, which was utilized in part. [94]

I left the employ of the Shell Company and went back into private practice. I was then employed by the Amalgamated Oil Company for about two years, until July, 1922, when I entered the employ of the Federal Government.

Since then my job has been the valuation of oil and gas produced, for the purpose of determining depletion and gain or loss on sale of capital assets and determination of reserves for both oil and gas.

I am familiar with the question of amortization

(Testimony of F. K. Baxter.)

for casinghead contracts for income tax purposes. It became a problem of considerable importance about 1923, at which time I made a study of the subject. I have been engaged in that study ever since.

The question of allowance of percentage depletion for wet gas first came up for consideration for income tax purposes about 1926. There has never been any provision in the regulations allowing for depletion of that sort. In stating that, I had in mind particularly the amortization of casinghead contracts. I know the law never provided for any such return to be considered as depletion. The regulations specified that casinghead gas contracts, being considered capital assets, might be returned by adding their cost to the capital sum returnable through depletion. However, when the percentage depletion allowance came into effect as of January 1, 1925, the corresponding regulations were silent as to any amortization for casinghead [95] gasoline contracts, and all regulations since have been silent on that subject. A casinghead gas contractor could have no depletory sum prior to the time he got the contract. He would have no capital sum to which to add the cost of casinghead gas contracts. The nature of the depletory interest from an engineering standpoint is an interest of an operating owner who owns the fee or we may say the mineral estate, the same operating owner becoming a lessee under that lessor, a sublessee under a sublessor, or the assignees of any of the aforementioned. And we have now come to

(Testimony of F. K. Baxter.)

the point where anyone owning any of the previously mentioned interests assign such interest, retaining a right to receive income therefrom as distinguished from a mere right to receive income acquired by direct purchase, and not predicated on any prior interest in the particular property.

Gas is the personal property of the operator after reduced to possession. I term that a depletory interest.

As engineering revenue agent I have examined numerous casinghead contracts.

Witness was then shown Exhibits 1 and 2.

By contractor I mean the operator of the casinghead plant.

The natural gas is taken at the well or at the gas trap and conveyed to the treatment plant where the pressure is raised or lowered, as necessary. The gas is brought in contact with absorption oil and the gasoline is absorbed by the oil. The oil is afterwards retorted and the casinghead gasoline separated from the oil. That process involved considerable machinery and equip- [96] ment, and requires a considerable outlay for a plant.

Going into a more detailed description, the gas first goes through a scrubber, which is supposed to take out any oil that might be conveyed, after which the pressure is properly adjusted to the plant, usually about 42 in many plants above atmosphere, and there are cooling processes, and finally the gas finds its way to the absorption tower, where it is brought in close contact with the oil. There are dif-

(Testimony of F. K. Baxter.)

ferent partitions in the absorption tower so as to make the best contact possible and permit the oil, which has a gravity ordinarily varying from 29 to 35 degrees—that oil is supposed to be devoid of these same hydrocarbons which are represented by the gasoline vapors and therefore, has an affinity or power of absorbing these particular carbons, and when the process is continued for a sufficient time that absorption oil, as I said before, is retorted and the gasoline fraction removed.

The gasoline is further treated to eliminate the so-called wild product, after which it is sold for blending purposes or for other purposes, and the dry gas is then raised to the necessary line pressure to enter the lines of the purchaser. As a rule it goes to a public utility. To whom the casinghead man returns it depends upon each particular contract. Exhibits 1 and 2 do not vary as to their method of treatment of gas.

I am familiar with the types of casinghead contracts used by the various operators. There are several types of those contracts. When I say type, I mean changes in wording. There is [97] one type which says that the producer agrees to sell and the casinghead man agreed to buy. The other merely provides for the treatment of gas. In some cases it is provided that all the dry gas, except that required for gasoline plants, should be returned to the producer, and he can either market it himself or burn it on his own property, or blow it into the air, or use it for repressure. Sometimes the gas is recirculated

(Testimony of F. K. Baxter.)

back through the formation to absorb more gasoline. That gasoline is either sucked out of the well under vacuum, or if the pressure is great enough will issue from the well under its own pressure. It is then returned to the plant. Under those circumstances it merely acts as a mechanical conveyor of gasoline. Some gas treated in the plant is represented by true natural gas, but the larger element is composed of gas that has been through the plant before and has completed its circulation. Many times the gas which is forced back into the formation does tend to increase the production of oil, and that oil is usually of lower gravity because of the absorption of the lighter hydrocarbons. In other words, a large amount of gas goes through the absorption plant several times.

The treatment of casinghead gas is primarily for the purpose of separating an unsalable product—unsalable in the sense that public utilities would not accept it. It is salable only to one who has a casinghead plant, or knew of a casinghead plant to which he could dispose of his gas. Wet gas is usually unsalable and must be treated. There are two products from wet gas—gasoline [98] and dry gas, both of which are salable. In the early days wet gas was used primarily for boiler fuel or lease fuel. Before gas is valuable for domestic use, the gasoline must be extracted. In some of the contracts with which I am familiar, the dry gas belongs to the casinghead contractor, while in other cases it belongs to the producer, and is sold under his instructions. The

(Testimony of F. K. Baxter.)

casinghead man sells it for his account and accounts to him.

There is no price per unit for wet gas in California for the reason that no one knows what the wet content of the gas will be. Different wells on the same lease show a different gas content at the same time, and the same well over its life will yield wet gas that varies in gasoline content. As the pressure lowers, the gasoline content increases, but the volume of gas decreases. Wet gas is never sold on a basis of a unit price in California, but is sold under a gas treatment contract in which the contractor agrees to pay a certain percentage of the gasoline, retaining a certain part of the dry gas for use in the plant, and returning all or a portion of the dry gas to the producer. In some cases the operator of the well sells the gasoline to the casinghead man for a price contingent on the yield of the gas. There are some contracts in which the casinghead gas contractor furnishes his services as an extractor and turns the dry gas back to the owner. That is the class I have called the gas treatment contract. In my experience I found [99] two broad types of contract—the gas treatment and the purchase and sale contract. The casinghead man accounts to the operator of the well for the dry gas sold. The dry gas is no more a by-product of gas operations than is gasoline. The public utilities purchasing dry gas require it to be just as dry as possible. Whether the dry gas or the gasoline is a more valuable part of the wet gas depends entirely on the gasoline content

(Testimony of F. K. Baxter.)

of the natural gas. I know of certain cases where the lessor was required to pay not only all of his share of the gasoline produced but a portion of his share of the income from the dry gas produced in order to have his wet gas processed. That situation arose from an agreement whereby the lessor agreed to stand his pro-rata share of the treatment process, and that prorata share was in excess of the lessor's share of the gasoline sold and extracted. The gasoline must be extracted from wet gas to make the gas marketable and also to make the gasoline salable.

I have examined a number of gas contracts, and from that examination I have seen contracts providing for higher rate of royalty than that provided for in petitioner's Exhibits 1 and 2. I have also seen numerous contracts providing for a rate of 33-1/3%. or less.

There is no question but the royalty rate increased from 1923 to 1928. In 1923 there were more at 33-1/3% than there were at less than 33-1/3%. That was the usual rate in 1923—33-1/3%. Gradually the rate has increased, as has been testified to here, and up to 37½ and 40 to 45 and up to 50. I have found [100] numerous contracts at 33-1/3% in the years 1926 to 1928. I could not attempt to say what companies they were.

The first gas extractor plants in California were erected by the oil operators for the purpose of treating their own products. That continued until the flush fields came in in 1921, 1922 and 1923. Then independent operators who secured their gas from

(Testimony of F. K. Baxter.)

the producers by contract began to build plants for the treatment of the gas. Wet gas is always produced in conjunction with oil in California.

It was stipulated by and between petitioner and respondent that casinghead companies under contract providing for a 33-1/3% royalty keeps 2/3 of the gasoline and 1/3 of the gasoline is returned to the producer of the oil and he divides it with his lessor in accordance with their lease contract.

(The Witness): It is usually provided that a substantial part of the dry gas, between 66-2/3 and 75%, remains the property of the producer. The gas does not strictly remain the property of the producer, because the gas when used is commingled with gas from many different properties. A casinghead company may have a contract with fifty different producers from which it secures wet gas which is commingled in the plant. They then make a test to determine what each producer's proportion of the commingled amount it, and when the producer gets his gas or gasoline back, it is not necessarily the gas or gasoline that came from his property, but is a percentage of the commingled [101] wet gas. That, of course, is not true where a plant merely takes the gas from one operator. In that event the dry gas remaining after treatment is returned to that operator, or is sold either by the casinghead plant to a public utility as agent for the operator. The utilities as a rule pay the casinghead plant, and the casinghead plant settles with the producer. The gasoline produced very often goes to a refiner. He pays the

(Testimony of F. K. Baxter.)

casinghead operator usually, but sometimes it is provided in the contract that the producer's share shall be paid directly to him.

The pipe lines of a casinghead plant are connected directly with the well or a gas trap. That is a device to separate oil that is carried along with the gas. In recirculating operations dry gas from casinghead plants is introduced into intake wells under pressure for two purposes—to increase the production of the oil and to absorb gasoline vapors from the gas. This is done in fields in which the rock pressure or natural pressure has gone down. That is a substantial part of the cost of operating an absorption plant. They often put the pressure on the gas for injection purposes, although the producer, with the consent of the lessor, puts it into the wells. Some of this gas is used over and over again in the case where the gas is drawn from one source. Of course there is no means of identifying that.

The casinghead contractor, on receiving delivery of [102] wet gas, takes it to his plant to separate the gasoline from the dry gas. He thereafter sells the gasoline and sometimes the dry gas as well. He sometimes is required to repressure the property, that is, with his compressors he must raise the gas to the required pressure for injecting it. Sometimes gas from other fields is injected. The component parts into which wet gas is separated are generally gasoline and dry gas, and sometimes butane and lamp black. The usual contract deals with nothing

(Testimony of F. K. Baxter.)

but the gas and gasoline. After the rock pressure has subsided, wells are pumped under vacuum. When the production of natural gasses decreases they have to inject gas or there would not be enough for treatment in the gas plant.

By foreign gas I mean gas from other fields or in other properties. Gas which has been injected for repressuring purposes is a natural gas but not a natural product. It is merely a mechanical device to force the oil towards the well and for the absorption of gasoline vapors.

Cross-Examination

By Mr. WEIL:

If a casinghead plant is being supplied by three different properties, the gas from those three properties is not kept separated as it goes through the plant, but it is all commingled. The gasoline content per thousand cubic feet of gas at Signal Hill and Santa Fe Springs varies about half a gallon up to two and a half or three gallons at the present time. There is [103] probably not any property in Santa Fe Springs producing as low as half a gallon right now. I can't name any property in either field producing less than a gallon and a half of gasoline per thousand cubic feet of gas at the present time.

In 1930 the price of casinghead gasoline averaged from 7¢ to 10¢ per gallon. So there would be from 10¢ to 15¢ worth of gasoline in a thousand cubic feet of gas, figuring on the basis of a gallon

(Testimony of F. K. Baxter.)

and a half per thousand cubic feet. In 1930 the public utilities were paying 10¢ per thousand cubic feet for gas under contracts they had entered into prior to 1930. I don't know what they would have paid in 1930. If a thousand feet of gas were produced from a well in 1930, and it went to a casing-head gasoline plant which had the right to sell both the dry gas and the gasoline, not under contract but on spot delivery, there is no doubt but that he would receive more money for the gasoline. In 1927 a very substantial quantity of dry gas was blown into the air. I don't know whether or not a larger amount was blown into the air or utilized, but I know a tremendous amount was blown into the air and wasn't used at all.

If a well is flowing under natural rock pressure they do not inject dry gas. Dry gas is used in two ways in the production of oil. One is by gas lift, where the dry gas is injected into the well that is being produced and is allowed to go out below the surface of the liquid in the well. In this case the bubbles thereby caused help the production. When gas is circulated it is [104] injected into so-called intake wells which are not producing at the same time. In that case the gas going into the formation will, it is hoped, produce oil and absorb gasoline vapors from the oil formation. In other words, it is put into the well itself in order to bring the oil out of that well, or it is put into the formation elsewhere to push the oil out through some other well. I do not know of any well where they ever put in gas

(Testimony of F. K. Baxter.)

for the mere purpose of absorbing the gasoline. Their purpose was to increase the production of oil, but the results were that the principal benefit was derived from the absorption of gasoline from the formation by the dry gas.

The casinghead plant operator is interested in getting gas from the formation so that he may secure the wet gas issuing from the well. I think some oil operators try to increase the amount of gasoline because I know of cases where the lessor has put a stop to the practice on the ground that he was not getting his full share. Gasoline taken by the gas injected is not necessarily taken out of the oil. There might be some gasoline vapors in the interstices that would come out with the oil if no gas were interjected, but only very slowly.

Redirect Examination

I do not recall how much gasoline was being wasted in 1927 to recover dry gas. I know it was a comparatively small amount that would get into the dry gas lines. I know of contracts where a lessor made a contract with his lessee to treat [105] the lessee's gas in the lessee's plant on the understanding that the lessor would get a percentage of the gasoline subject to a prorata share and cost of operation, and the cost of operating was raised to such an extent that the lessor was paid not only his share of the gasoline recovered, but a good portion of his income from the dry gas. The production other than gasoline and dry gas had a substantial

(Testimony of F. K. Baxter.)

value. The money realized from butane and lamp black was not a material portion of the income received in 1927.

In determining the comparative values of gasoline and dry gas produced, we must take into consideration that in recent years the state has compelled curtailment under the Natural Gas Waste Law. That was in the last five years. The comparative value of the two products depends upon the gasoline content of the gas. If the gasoline content was small, the value of the dry gas would be greater if there were a market for it. But in many fields they had to waste a great deal of it. For example, in Ventura, even though they had some pretty heavy contracts with utilities, a vast amount of gas was blown into the air. California was producing more natural gas than they knew what to do with.

Respondent thereupon rested. [106]

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned as attorney for petitioner.

A. L. WEIL
MARTIN J. WEIL
Attorneys for Petitioner on Review.

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of

Tax Appeals, and the same is approved by the undersigned as attorney for respondent.

HERMAN OLIPHANT
Attorney for Respondent on Review.

This statement of evidence is duly approved and ordered filed this 21st day of July, 1936.

LOGAN MORRIS
Member
United States Board of Tax Appeals

[Endorsed]: Filed July 21, 1936. [107]

[Title of Court and Cause.]

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled causes in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by Bankline Oil Company, your petitioner.

1. Docket entries of the proceedings before the Board in each of the above docket numbers.

2. Pleadings before the Board in each of the above docket numbers:

(a) Petition, including annexed copy of deficiency letter and all exhibits attached to petition.

(b) Answer.

(c) Amended petition, (including annexed copy of deficiency letter and exhibits attached thereto; duplication is not included).

(d) Answer to amended petition.

3. Order granting motion to file amended petitions.

4. Findings of fact, opinion and decision of the Board.

5. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

6. Statement of the evidence as settled and allowed.

7. This praecipe.

A. L. WEIL
MARTIN J. WEIL
Attorneys for Petitioner.

Service of a copy of the within praecipe is hereby admitted this 23rd day of June, 1936.

HERMAN OLIPHANT
Attorney for Respondent.

[Endorsed]: Filed June 23, 1936. [109]

[Title of Court and Cause.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 109, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 28th day of July, 1936.

[Seal] B. D. GAMBLE
Clerk,
United States Board of Tax Appeals.

[Endorsed]: No. 8294. United States Circuit Court of Appeals for the Ninth Circuit. Bankline Oil Co., a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed August 3, 1936.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.